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Research Bulletin

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New Deadlines for Outsourcing in U.K. Local Government

Local government in the U.K. has not always been considered to be at the forefront of business practice. However the U.K. local government sector is now poised to become arguably the most advanced outsourcing market in the world since:

- Timetables have now been introduced for compulsory competitive tendering across IT and a range of business functions.
- Eighty per cent of IT functions must be considered for outsourcing
- Business operations outsourcing will become widespread in the sector.

Timetables for Compulsory Competitive Tendering

There are few sectors which currently show high levels of activity in both IT outsourcing and business operations outsourcing. However, the U.K. local government sector already shows high levels of activity in these forms of outsourcing. Outsourcing in this sector will increase dramatically over the next five years driven by the government's concept of an "enabling authority". An "enabling authority" is a local authority which is responsible for the delivery of services to the public, but which does not undertake service delivery itself.

To encourage local authorities to adopt this philosophy, the government has introduced a timetable for Compulsory Competitive Tendering (CCT). This specifies for each business function within local authorities:

- The date by which local authorities must introduce competition.
- The proportion of the business function which must be subject to competitive tendering.

While the precise timing remains subject to amendment, one of the first activities scheduled for CCT is legal services in October 1995.

However, the business functions currently scheduled for the introduction of competition by 1st October, 1996 are potentially of greater interest to IT vendors. These functions, together with the proportion of their activity which must be subjected to competition, are listed in Exhibit 1.

Exhibit 1

Proportions of Activity Subject to Compulsory Competitive Tendering

Business Function	Proportion (%)
Information technology	80
Finance	25
Personnel	25
Corporate Adminstration	15

In addition, the housing function of local authorities is timetabled to be subject to CCT by April 1996.

Eighty Per Cent of IT Services Subject to CCT

Exhibit 2 shows INPUT's forecast for IT outsourcing in the U.K. local government sector.

At present, the IT spend of this sector is approximately $1.5 billion. Assuming that a reduction in expenditure of 20% is achieved over the next five years and that the CCT proportion remains at 80%, then the potential IT outsourcing market in 1998 is $1 billion.

The forecast shown above assumes that external vendors are successful in competing for approximately 50% of the services put out to tender. The leading vendors in supplying IT outsourcing services to U.K. local government at present are ICL/CFM, Telecom Capita, and ITnet.

Exhibit 2

U.K. Local Government IT Outsourcing Market

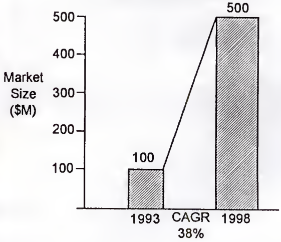
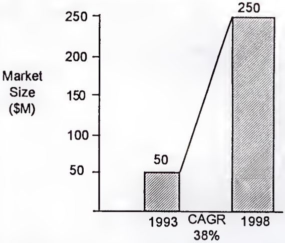


Exhibit 3

Business Operation Market, Local Government, U.K.



Business Operations Outsourcing Will Become Widespread

The expected growth in the local government business operations market is shown in Exhibit 3.

This forecast is based on the assumption that outsourcing vendors will win approximately half of the service contracts put out to tender, and that on average 20% of the legal, finance, personnel, corporate administration, and housing services of local authorities will be subjected to CCT within the forecast period. Current expenditure on these services is approximately $2.5 billion. This forecast excludes blue-collar services.

IT vendors may choose to target a wide range of business functions within local authorities.

However the finance function has the greatest synergy with IT services, and it is in this area that IT vendors have principally begun to develop their business operations capability.

The leading vendors serving the white-collar business operations market in U.K. local government are listed in Exhibit 4.

Exhibit 4

Leading Vendors, 1993 Business Operations, U.K. Local Government

Vendor	Estimated Revenues ($M)
Capita Group	10
Touche Ross/CSL	8
ITnet	3
Hoskyns	2

The Capita Group is the current market leader in this area. Examples of Capita's business operations contracts include:

- A contract with East Cambridgeshire DC to manage the council's revenue function
- A $8 million per annum contract with Bromley LBC to manage exchequer services.

CSL has recently been acquired by the consultancy Touche Ross. CSL's business operations contracts include:

- Payroll processing, pensions administration and revenue collection on behalf of Oxfordshire CC
- A $3 million per annum contract to manage the housing operations of Rutland DC.

CSL was also involved in the privatisation of Berkshire CCs finance department and has an option to purchase the resulting concern.

ITnet has added a financial services business operations contract to its IT outsourcing contract with Hertfordshire CC. In addition a number of other IT outsourcing vendors are endeavouring to develop a business operations capability to serve the local government sector.

In the future, IT vendors will need to offer a combination of IT outsourcing and business operations outsourcing capabilities to achieve credibility in the U.K. local government outsourcing market.

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SAP Outsourcing Vendors Need to Identify New Markets

Traditionally the SAP outsourcing vendors in Germany have targeted medium-sized manufacturing companies. These companies could not justify the cost of running their own mainframe, and employing all the associated systems engineering personnel, but still wished to take advantage of the facilities offered by R/2. Accordingly the purchase of processing services was appropriate for their needs.

However with the introduction of R/3, these medium-sized manufacturing organizations can now purchase a combination of equipment and software more appropriate to their needs.

This poses a threat to the SAP processing services vendors such as tds, Alldata, DVO, and BB-Data. In response to this threat, these organizations may have to change either their target market or the nature of their offerings.

There are a number of ways in which the SAP outsourcing vendors can adapt, including:

- Offering transition outsourcing services to larger manufacturing organizations
- Developing distributed systems outsourcing capabilities
- Targeting outsourcing contracts worth less than DM5 million.

Offering Transition Outsourcing Services to Larger Manufacturing Organizations

Exhibit 1 shows a breakdown of the outsourcing market, including SAP outsourcing, in Germany.

Exhibit 1

Outsourcing Market Germany, 1993

Segment	Market Value (DM million)	Proportion (%)
Platform Operations	180	18
Desktop Services	80	8
Network Management	155	15
Applications Operations	125	12
Applications Management	23	2
SAP Outsourcing	470	45
Total Outsourcing	1,030	100

Source: INPUT

At present the SAP outsourcing market comprises nearly half of the total German outsourcing market. However the proportion of the market accounted for by traditional SAP R/2 outsourcing will fall over the next five years as organizations make the transition to R/3 and as the systems operations market in Germany shows high growth.

While the SAP outsourcing vendors can be expected to lose some of their medium-sized clients for R/2 processing, the introduction of R/3 will create additional opportunities for R/2 outsourcing in the larger manufacturing organizations that currently run their own R/2 installations.

At the end of 1992, there were approximately 1,500 installations of R/2 in Europe, with the majority of these located in Germany. Most of the organizations using these systems will migrate from R/2 to R/3 over the next five years.

Organizations will have difficulty in managing and staffing all aspects of these migrations themselves. A typical response will be for organizations to concentrate their own resources in understanding and implementing R/3.

This will create opportunities for vendors to manage the former R/2 environment, or at least those elements of the R/2 system that are being replaced in the short- to medium-term.

In some cases, organizations will entirely replace R/2 with R/3. In these situations, vendors can acquire the equipment from the client and consolidate the provision of R/2 to the client from the vendor's site for a limited period, while R/3 is being implemented. In other cases, organizations may be prepared to transfer their R/2 installations to vendors in return for a phased run-down of their R/2 service over a period of up to five years.

Transition outsourcing is not solely limited to the provision of R/2 based services. Organizations using other mainframe-based MRPII systems such as those from IBM, Dun & Bradstreet, and Computer Associates may also wish to migrate to R/3.

Accordingly opportunities will exist to offer additional transition outsourcing services based around the appropriate product e.g. IBM's COPICS.

Developing Distributed Systems Outsourcing Capabilities

The client/server environment that will become increasingly adopted by R/3 users can be a very demanding environment to manage. At present, few in-house IT departments have the appropriate skills and it can be difficult for these organizations to assemble a coherent set of systems management tools for this environment.

Accordingly there is a growing demand for vendors to manage the client/server based infrastructure.

This is another opportunity that could be addressed by the SAP outsourcing vendors. It is also a means of retaining their current client bases if their traditional clients begin to migrate from using R/2 based processing services and adopt their own R/3 based installations.

The main competition to the SAP outsourcing vendors in this segment of the market will come from Hewlett-Packard and Digital who are broadly targeting distributed systems outsourcing.

Targeting Small Outsourcing Contracts

The leading outsourcing vendors in Germany are listed in Exhibit 2.

Over the last two years, major vendors such as debis Systemhaus, EDS, and IBM have established themselves in the German systems operations market.

It will be difficult for the traditional SAP outsourcing vendors to compete with these organizations for major systems operations contracts. The critical success factors in winning large platform operations contracts include financial size and stability, and price. The SAP outsourcing vendors are typically much smaller companies than these major vendors and will have greater difficulty in achieving economics of scale in platform operations. In addition, they typically lack the systems integration and major project management skills essential for success in applications operations.

However there is scope for the SAP outsourcing vendors to target the smaller platform operations and transition outsourcing contracts worth around DM1 million per annum. In this segment, their comparative lack of financial size is less important. In addition the major systems operations vendors will tend to concentrate on contracts with higher values.

Exhibit 2

Leading Outsourcing Vendors Germany, 1993

Rank	Company	Estimated Market Share (Percent)	1993 Estimated Revenue (DM Millions)
1	debis Systemhaus	17	180
2	EDS	12	120
3	Alldata	10	100
4	tds	4	40
5	IBM	3	30
5	AC Service	3	30
5	Digital	3	30
8	Fiducia/Orga	2	20
8	CSC	2	20
10	Taylorix	1	15
	Total Listed	57	585
	Total Market	100	1,030

Source: INPUT

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British Aerospace Adopts Outsourcing to Improve Efficiency

British Aerospace is now (February 1994) within a few weeks of signing a £1.5 billion outsourcing contract with CSC. Many of CSC's outsourcing clients appear to be motivated by a need to re-engineer their business processes and re-align their IT support accordingly.

However British Aerospace was apparently primarily motivated to consider outsourcing by the need to improve the efficiency of its IT operations.

Overall British Aerospace is seeking:

- To achieve immediate economies of scale
- A cash injection and ongoing cost reduction
- To retain some flexibility in development

Achieving Immediate Economies of Scale

At the current time, British Aerospace has a strong need to improve its financial position. This has been manifested in the disposal of a number of subsidiaries including the sale of the Rover Group to BMW, an action which has attracted considerable criticism in the U.K.

Towards the end of 1992, the CEO of British Aerospace sponsored a study to evaluate the relevance of outsourcing. A small working group was established to identify how economies of scale within IT could be achieved.

British Aerospace has annual revenues of £9 billion. However the organization is divided into fourteen autonomous business units covering separate activities such as the manufacture of military aircraft, Airbus production, and royal ordnance. Each business unit manages its own IT. An IT director for the British Aerospace Group was not appointed until 1992.

However this led to a very fragmented IT organization including eight separate IBM data centres. In addition, each business unit had its own application team and a heritage of legacy systems.

The CEO was apparently no longer prepared to tolerate these inefficiencies.

To identify how best to achieve economies of scale, British Aerospace assembled two in-house teams:

- One to evaluate proposals from outsourcing vendors
- Another to prepare an in-house proposal.

The timescale of the bidding process is shown in Exhibit 1.

The in-house team did produce a bid which demonstrated significant economies of scale. However British Aerospace decided to outsource since:

- It was considered unlikely that all of the autonomous business units would agree to go along with an in-house unit
- It was perceived that the current IT staff were unlikely to rapidly enhance the organization's use of new technology
- Outsourcing of the IT function was seen to be consistent with the corporate policy of British Aerospace to focus on its core business.

Certainly the individual business units had a fear of losing their autonomy. This fear would have been compounded by the creation of a powerful central, in-house IT unit.

Aiming for a Cash Injection and Ongoing Cost Reduction

Another difficulty faced by British Aerospace was that each of its business units had its own agenda for IT.

Exhibit 1

Timescale of Bidding Process

Dec 1992	- Commenced outsourcing feasibility study
	- Initial request for information - select 10 bidders
April 1993	- Bidders conference - reduced to 5 bidders
	- Downselect to 3 bidders
June	- RFP issued
	- Referencing - U.S., Europe
	- Bidders visit BAe sites
July	- Proposals received
	- In-house proposal completed
August	- Initial assessment
	- Business units become involved directly
September	- Commercial negotiations
October	- Update of in-house proposal
	- Moving towards decision
	- Preparation of business units for managing process

Source: British Aerospace

Some business units believed that the IT budget had been out of control by the end of the 1980's and feared that a third party would push up costs further. These business units primarily sought cost savings. Certainly British Aerospace had been a comparatively high spender on IT during the 1980's spending several times the industry standard proportion of revenues on IT.

Other business units had now significantly reduced their spending on IT but their comparatively lean IT organizations lacked the capabilities to adopt new technology.

However British Aerospace wished to place all accountability for its IT on a single contractor.

To enable British Aerospace to achieve its objectives of an immediate cash injection and ongoing cost reductions, the contract is being divided into two parts:

- The first part is the sale of British Aerospace's IT business including all equipment and software assets. British Aerospace is endeavouring to transfer all third party software licences to CSC at no extra cost and claims to have been largely successful in meeting this objective.
- The second part is a contract to buy back the service.

In this second part of the contract, British Aerospace is adopting a pricing policy that contains incentives for CSC to continue to reduce its IT costs.

The IT Director of British Aerospace perceives that when the outsourcing exercise commenced, IT was viewed by the business unit managing directors as a technical subject with high costs. By the end of the exercise, the business unit managing directors were more prepared to become involved in establishing IT strategies for their units.

Retain Flexibility in Systems Development

However many of the senior managers in British Aerospace's business units still find it difficult to identify their future IT requirements.

Accordingly British Aerospace is endeavouring to assemble a contract which will cater for future changes in IT strategy. British Aerospace is outsourcing:

- All of its IBM and Digital data centres
- Its networks and distributed systems
- Its applications.

The company is retaining all aspects of IT embedded within its own products, and the strategic management of IT.

Because of the uncertainty of British Aerospace's requirements, the company is also retaining some flexibility in its development sourcing and is providing for some activities to be potentially subject to competitive tender.

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Vol. V, No. 5

March 1994

EDS Successfully Targeting U.K. Central Government

Until 1993, EDS achieved only low levels of success in the U.K. outsourcing market. In 1992, EDS was awarded just one outsourcing contract in the U.K. namely a small contract with Pilkington Glass.

However, in 1993, EDS positioned itself to become potentially the major outsourcing vendor to the U.K. central government for the next decade. EDS has achieved this position by:

- Becoming the preferred strategic partner to the Inland Revenue
- purchasing the DVOIT Agency from the U.K. government.

Preferred Strategic Partner to the Inland Revenue

On November 23rd 1993, the Inland Revenue announced that it had chosen EDS as its preferred strategic partner for the outsourcing of its Information Technology Office (ITO).

However, discussions on establishing a detailed contract are still progressing. Negotiations are expected to be completed by the end of March 1994, if talks proceed smoothly. The contract will be for ten years and at its peak will be worth approximately $300 million per annum.

The Inland Revenue originally envisaged that the functions of its ITO would be transferred to its preferred supplier over four stages. Improved value for money must be demonstrated at each stage prior to transfer of the corresponding IT functions. The first of these stages was perceived to be the transfer of the organisation's data centres. The Inland Revenue currently has thirteen data centres in the U.K..

However, EDS has proposed that the transfer of the ITO's functions takes place in two stages, rather than the four initially proposed by the Inland Revenue, and it is probable that EDS' proposal will be accepted.

Provided negotiations proceed smoothly, the computer operations of the Inland Revenue will be transferred to EDS in April 1994, with the organisation's development functions being transferred subsequently. Eventually approximately two thousand civil servants will be transferred to EDS.

The Inland Revenue is not prepared to discuss the reasons why EDS was selected while negotiations are still underway. However, the organisation's objectives in outsourcing its ITO were:

- To improve the cost-effectiveness and service levels of its IT operations
- To gain access to the latest technology and development tools
- To speed up the timescales for the development and enhancement of systems
- To provide improved career opportunities for its IT personnel

Hence it is clear that the Inland Revenue not only wants to reduce the cost of its IT infrastructure but also needs to improve significantly its performance in new systems development.

The U.K. government needed to minimise the risks in choice of supplier for the Inland Revenue outsourcing contract to demonstrate the success of its politically controversial Market Testing programme. This tended to favour the leading US outsourcing vendors EDS and CSC, since there are no European vendors that can demonstrate experience in managing contracts worth $300 million per annum.

Purchase of the DVOIT Agency from the U.K. Government

DVOIT is the former information technology arm of the Drivers & Vehicle Licensing Agency (DVLA), which was established as an Executive Agency in April 1992. DVOIT was established as a separate agency with a view to future privatisation. DVOIT was a $45 million turnover business employing 500 personnel.

With the announcement on 11th November 1993 of the government's intention to sell DVOIT to EDS, DVOIT became the first Government Executive Agency to be privatised.

DVOIT supplies computing services to a number of clients and the government faced the choice of either separately market testing the supply of computer services to each of DVOIT's clients or selling the entire DVOIT operation as a going concern. The government decided on the latter course of action.

Approximately twelve vendors expressed a serious interest in purchasing the DVOIT Agency. These twelve applications were reduced to a shortlist of three by the Department of Transport. The three organisations shortlisted were:

- EDS
- CSC
- A consortium formed between IBM and the DVOIT management team.

These organisations were evaluated in terms of:

- Their ability to meet acceptable quality of service standards
- The price they were prepared to pay for DVOIT as a going concern
- The rates they would commit to charging DVOIT's customers over the next five years.

All three organisations are believed to have satisfied the quality of service requirement. In addition, EDS made the best offer in terms of the combination of the price it would pay for the DVOIT Agency and the rates it would charge to existing customers over the next five years. The level at which these rates have been set is likely to have been the decisive factor. In particular, the ongoing delivery of mainframe-based services forms the major component of the business, and the pricing of these services would have been particularly critical.

EDS paid the U.K. government $8 million for the DVOIT Agency. IN return, EDS received:

- The acquisition of DVOIT including 370 personnel and offices in Swansea
- Contracts to supply IT services to the Department of Transport and its agencies for a five year period

The principal contracts are with:

- DVLA - which handles all driver licensing, vehicle licensing and vehicle registration
- Vehicle Inspectorate - responsible for vehicle roadworthiness
- Driving Standards Agency - responsible for the administration of driving tests and maintaining a register of approved driving instructors
- A number of central functional areas within the Department of Transport

The Department of Transport expects to save money on the ongoing delivery of operational services via its contract with EDS, and it is probable that operational services will form the major part of the revenues over the life of the contract. However, it is anticipated that existing systems will also be replaced or enhanced during the life of the contract, and the Department of Transport believes that EDS will be able to provide it with pro-active advice on improving the organisation's use of IT.

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Research Bulletin

A Publication from INPUT's Outsourcing Information Systems Programme – Europe

Vol. V, No. 6

March 1994

Rapidly Changing Technology Platforms Drive Need for Desktop Service Outsourcing

Users are typically very enthusiastic about the introduction of client/server architecture and PC-based IT services. However, they face practical difficulties in utilising these new technologies to their full potential. Major reasons for these difficulties include:

- Inadequate current levels of support
- Problems caused by the high rate of technological change
- A lack of pro-active assistance in utilising the technology

Users Require More Comprehensive Support

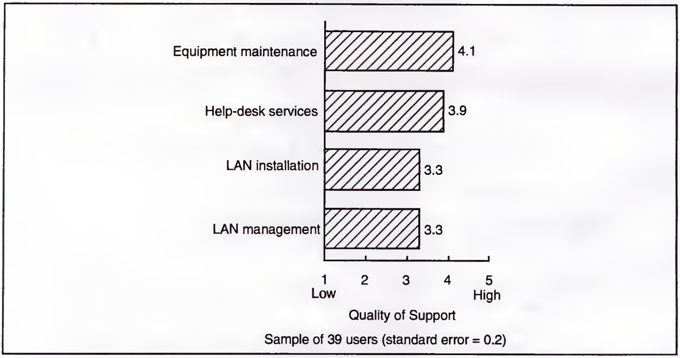
Users perceive that they require a more comprehensive support service than they currently receive. In many organisations, the expansion of desktop computing, accompanied by an increase in the number of LANs, is proceeding rapidly. In-house IT departments are facing difficulties in meeting the demands of this increasing user base.

In particular, it is important that the organisation's desktop support entity has the capability to support all departments within the organisation regardless of their geographic location and to support a comprehensive range of applications that are used within these departments.

Users are also seeking more knowledgeable desktop support. In addition to the rapid growth in the user population with access to desktop services, users are becoming much more sophisticated and placing greater demands on the service provider. For example, the need to link applications and to share data across platforms is becoming paramount. At the same time, many in-house service providers are facing severe financial, or headcount restraints, which limit their capability to respond. For example, one respondent complained that the organisation's in-house IT department had cut costs to become price-competitive with external suppliers and consequently service levels had noticeably declined.

Exhibit 1

Best Supported Functions Desktop Services—Europe



Source: INPUT

Technological Change Creates Problems for Users

Exhibit 1 shows the ratings users gave to the best supported desktop service functions.

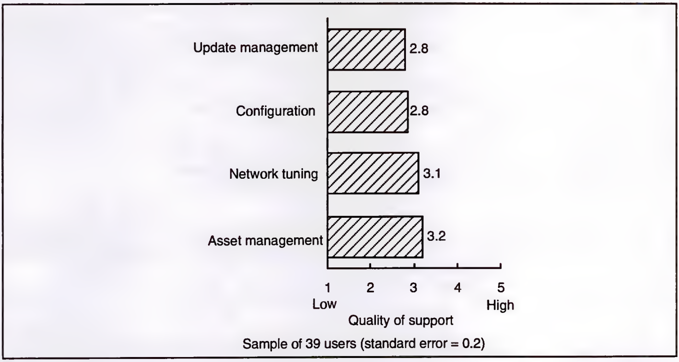
Users perceive the levels of support that they currently receive for maintenance and help-desk services to be high. Indeed, many organisations are considering relying solely on warranty for their desktop systems given the perceived high levels of reliability for this class of equipment. The quality of support on LAN installation and management is perceived to be only moderate at present.

Exhibit 2 shows the ratings users gave to the worst supported desktop services elements.

Update management and configuration management were perceived to be particularly inadequately supported, and asset management appears to be frequently handled within individual user departments.

Exhibit 2

Worst Supported Functions
Desktop Services—Europe



Source: INPUT

Users' need for support is exacerbated by the rapid rate of change in desktop technology. Two common complaints from users are:

- Inadequate hardware performance
- Rapid changes in the versions of operating systems and application software products

Many users are finding that their hardware is inadequate to run the latest software or data sharing becomes a problem as new versions of software products are introduced.

This situation creates a demand for two important components of desktop service namely, outsourcing update/version management and providing product financing/leasing services. In practice, update management is typically inadequately performed by in-house support functions. This may not be entirely their fault given user purchasing autonomy at the departmental level. Similarly, it is virtually impossible for an in-house IT department to combine products and service into a fee-based service. Nevertheless, this may be the only way for some organisations to overcome their lack of willingness to make the continuing investments necessary to maintain an up-to-date desktop environment.

Users Need a More Pro-active Support Service

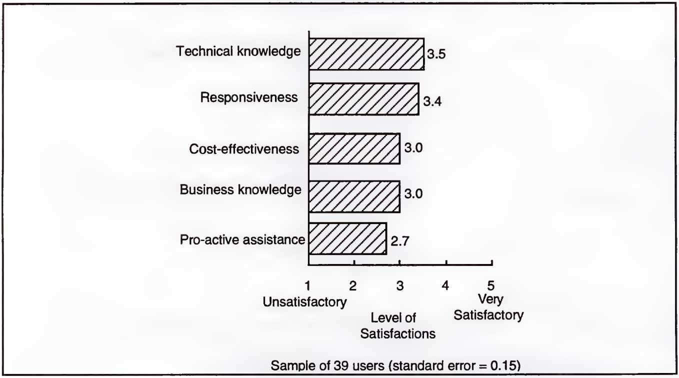
Exhibit 3 shows users' ratings of a number of key attributes of their current desktop support services.

Users are currently receiving a basic, reactive, technical support service that addresses their immediate technical queries. However users do not perceive this service to be particularly cost-effective nor to be sufficiently pro-active.

Ideally users require a support service that is forward looking and assists them in achieving greater productivity and fully utilising the potential of their desktop IT infrastructure. Hence, vendors should build into their desktop service offerings a consultancy element that assists users in identifying their future requirements so that these can be addressed. In addition, the help-desk service should enable the vendor to identify emerging problem areas and address them pro-actively. For example, the vendor needs to ensure that data sharing is facilitated between workgroups and departments and that incompatibility problems do not arise due to poor choice of software product or lack of version control.

Exhibit 3

Service Attribute Ratings
Desktop Services—Europe



Source: INPUT

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Vol. V, No. 7

April 1994

Organisations Show Strong Propensity to Contract Out Elements of Desktop Services

Some organisations are outsourcing their entire range of desktop services. However, other organisations are deciding to incrementally outsource only some elements of their desktop support needs. This phenomenon is recognised by vendors such as Hewlett-Packard and Digital who are offering desktop services outsourcing under service descriptions such as *Selective Outsourcing* and *Modular Outsourcing Services*.

Overall the level of interest in outsourcing desktop services is strong. At present, there is a higher likelihood of many organisations outsourcing elements of their desktop services than of outsourcing their mainframe datacentre operations. However, the attitudes of users and IT managers towards desktop services outsourcing show significant differences and they will tend to adopt differing patterns of contracting out. In particular:

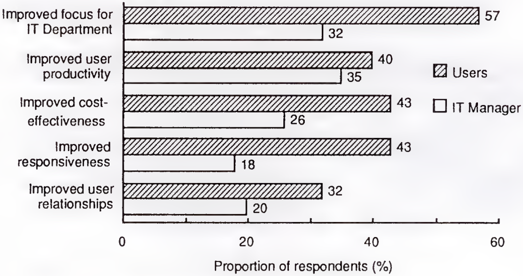
- A greater proportion of users rather than IT managers perceive that outsourcing desktop services leads to improved service responsiveness
- IT managers in particular, want second-line help-desk support
- Users show greater inclination to outsource asset and configuration management.

Users Perceive That Outsourcing Desktop Services Leads to Improved Responsiveness

Exhibit 1 contrasts the perceptions of users and IT managers. It shows the proportions of respondents in each category who strongly believe that outsourcing their desktop services would deliver each of the benefits listed.

Exhibit 1

Perception of Desktop Services Outsourcing Benefits



Note: Shows proportion of respondents scoring 4 or 5 (on a scale of 1-5) in answer to the question "To what extent do you think that outsourcing your desktop services would deliver each of the following benefits?"

Sample of 90 respondents. Standard error = 5.

Source: INPUT

Users are much more convinced than their colleagues in IT management that outsourcing their desktop services would generate significant benefits. However, unfortunately for vendors, IT managers are more likely to be in control of the decision to outsource. Even so, the fact that, on average, 25% of IT managers believe that each of these benefits can be achieved by outsourcing their desktop services means that there is a considerable market opportunity awaiting vendors.

The biggest divergences of opinion between users and IT managers are in the ability of outsourcing to deliver:

- Improved service responsiveness
- Improved focus for the IT department

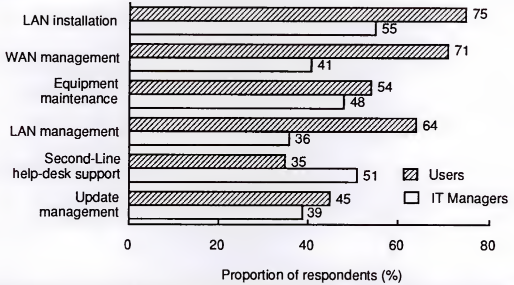
Over 80% of IT managers do not believe that an outsourcing vendor could improve on their level of responsiveness to their clients. However 40% of their clients disagree very strongly. An even larger proportion of users strongly believes that outsourcing desktop services would enable the in-house IT department to achieve better focus.

IT Managers Want 2nd-Line Technical Support

Exhibit 2 identifies the principal desktop service components where users and IT managers perceive that outsourcing could lead to an improvement in the quality of service.

Exhibit 2

Principal Areas Where Outsourcing Perceived to Improve Quality of Service



Note: Shows proportion of respondents scoring 4 or 5 (on a scale of 1-5) in answer to the request: "Please rate the level of contribution that outsourcing could make to improving the quality of each of the following service functions".

Sample of 90 respondents. Standard error = 5

Source: INPUT

One observation sometimes made about IT managers is that they view desktop outsourcing largely in terms of equipment maintenance. However, it appears that the majority of IT managers perceive that outsourcing would only improve the quality of service in two areas:

- LAN installation
- Second-line help-desk support.

INPUT's previous study into desktop services outsourcing in 1992 indicated a similar view.

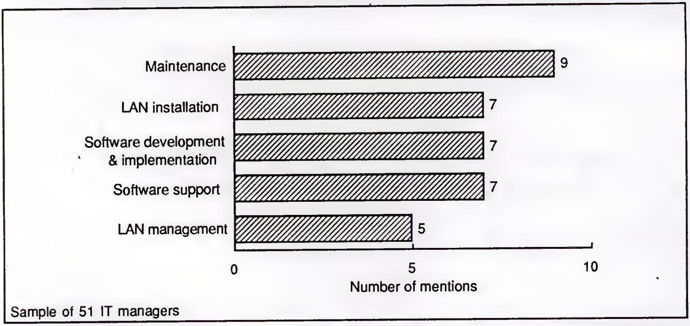
Perhaps surprisingly, the proportions of users and IT managers who believed that outsourcing first-line support would improve service quality were comparatively low. A very significant factor behind this low rating is the high number of bespoke applications still being accessed from the desktop even though these applications reside on mainframes or mid-range equipment.

Both users and IT managers perceived that external vendors would be ill-equipped to support the use of these applications. However this is a potential opportunity for vendors to consider offering application maintenance management as part of their desktop services portfolio. This could overcome one of the main obstacles in selling a more complete range of desktop outsourcing services to IT managers.

IT managers already admit that they require extensive technical back-up in supporting their desktop users.

Exhibit 3

Incremental Desktop Services Outsourcing Pattern: IT Managers



Sample of 51 IT managers

Source: INPUT

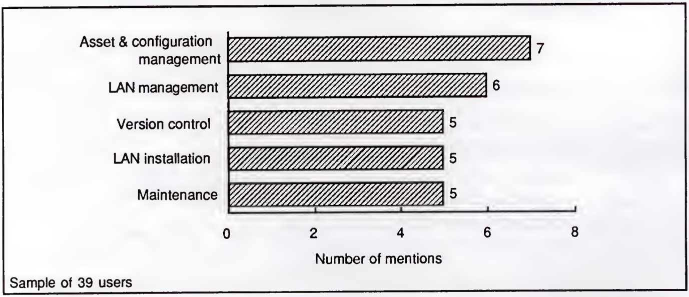
Users Want To Outsource Asset & Configuration Management

Users and IT managers were asked to nominate the service components that they would outsource if they were to adopt an incremental approach to desktop services outsourcing.

The service components receiving the highest number of mentions from IT managers are listed in Exhibit 3, while Exhibit 4 lists the service components that received the most mentions from users.

Exhibit 4

Incremental Desktop Services Outsourcing Pattern: Users



Sample of 39 users

Source: INPUT

Even though there are three items common to these exhibits, they still illustrate the differing concerns of the two groups. IT managers tend to be more concerned with access to implementation skills and technical support. On the other hand, users are more concerned with the operational management of their desktop systems. Asset and configuration management are often badly performed in-house much to the frustration of desktop users. Similarly inadequate version control can generate considerable day-to-day difficulties for users. Currently, there is a danger that IT managers under-estimate the value of these operational practices.

However, LAN installation and management are viewed as significant opportunities for contracting out by both types of respondent. Apparently a large number of IT departments lack the necessary technical and managerial skills to provide a high level of service in these areas. However, many IT departments may approach a vendor believing they only require short-term implementation assistance. They discover subsequently that management of the desktop environment is a very challenging task.

Indeed as LANs become increasingly connected as part of an enterprise-wide, multi-vendor IT infrastructure, so there is a growing need for vendors to combine WAN management with their desktop services to provide total operational management of the emerging client/server IT infrastructure.

Exhibit 2 demonstrated that significant proportions of users and IT managers believe that outsourcing could make a major contribution to improving the quality of their WAN services.

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Vol. V, No. 8

May 1994

Opportunity for Vendors to Establish High Profile in Desktop Services Outsourcing

Desktop services outsourcing is a rapidly growing opportunity, and during the past year, many vendors have developed offerings to target this opportunity.

However, at present, the overall level of awareness of individual vendors' desktop services capability is low. Consequently, an opportunity exists for vendors to establish high profiles in this market sector.

In doing so, vendors need to recognise the differing attitudes of users and IT managers towards desktop services outsourcing, and to recognise their relative levels of influence in the buying decision.

IT managers and users favour subcontracting differing elements of their desktop services. IT managers primarily want to outsource implementation and second-line technical support. Users are more inclined to outsource operational management services, such as LAN management, asset management, and configuration management.

Similarly, IT managers and users seek differing attributes in potential suppliers of desktop services. Vendors need to cater for these differing attitudes in their marketing of desktop services. In particular, vendors need to recognise that:

- Vendors' desktop services capabilities are presently being judged according to their overall profile in the outsourcing market, with the result that EDS is currently perceived to be the most suitable vendor for outsourced desktop services
- IT managers are the major influence on desktop services buying decisions
- IT managers perceive cost and level of technical skill to be the key vendor selection criteria
- Users are seeking vendors that can make a significant business contribution and supply them with high service levels.

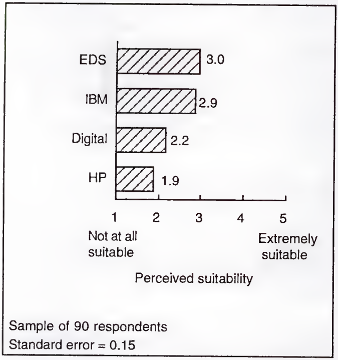
EDS Have Comparatively High Profile

The perceived suitability of each of a number of named vendors as potential suppliers of desktop services were analysed across France, Germany, and the UK.

Differing lists of vendors were used in each country. However, four vendors were common to each list. The ratings these vendors received at the European level are listed in Exhibit 1.

Exhibit 1

Perceived Vendor Suitability: Europe



Source: INPUT

These scores are a reflection of the immaturity of the desktop services outsourcing market. At present, no vendor is strongly recognised as a desktop services specialist. This creates an opportunity for individual vendors to establish themselves as leading players in this market.

The ratings shown above appear to reflect vendors' overall level of awareness in the outsourcing market, rather than being a specific judgement on the vendor's desktop services outsourcing capability. While no individual vendor receives a particularly high rating, vendors with a wider outsourcing capability including data centre management, such as EDS and IBM, currently receive higher ratings than Digital and Hewlett-Packard. Digital and Hewlett-Packard lack mainframe datacentre outsourcing capability but are strongly targeting the management of client/server infrastructures, including a major emphasis on LAN management and desktop services outsourcing.

Users and IT managers rank these four vendors identically in terms of their suitability as desktop services suppliers. However, there are differences in their ratings, with users showing comparatively higher levels of enthusiasm than IT managers for EDS' and IBM's capabilities. Overall, over 50% of users exhibit strong enthusiasm for EDS' desktop service capabilities compared to 20% of IT managers. The corresponding proportions for IBM are 35% and 25%.

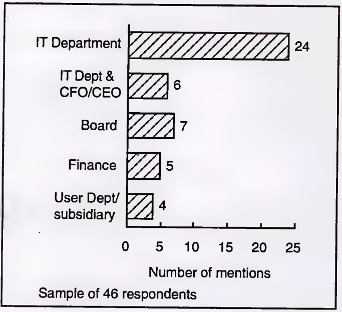
Similarly, IT managers give higher ratings to Digital and Hewlett-Packard than do users, possibly reflecting these vendors' more technical image in the IT services marketplace. In particular, there appears to be low awareness of Hewlett-Packard's recent positioning as a supplier of desktop outsourcing services. Only 4% of users and 8% of IT managers regarded HP as a credible supplier of desktop services.

IT Managers are the Major Influence on Desktop Services Buying Decisions

Exhibit 2 shows respondents' views of the major influence on desktop services expenditure.

Exhibit 2

Control of External Expenditure Desktop Services



Source: INPUT

Overall, IT managers were perceived to be in control of desktop services purchasing decisions in over 50% of organisations. Despite the much talked about transfer of purchasing power from IT managers to users, individual departmental and subsidiary managers were perceived to be in control of their desktop services expenditure in less than 10% of organisations.

Indeed, when questioned about LAN management, a key component of any desktop services outsourcing contract, IT managers were estimated to be in control of expenditure in 80% of organisations. Departmental and subsidiary managers were not considered to control this expenditure within a single organisation.

The other major influences on desktop services purchasing decisions are the CFO and the CEO, though decisions will often be taken by them in conjunction with representatives from the IT department. While the CFO and CEO are likely to be heavily involved in any major outsourcing decision, the IT department will typically remain a major influence on the vendor selection criteria adopted by the organisation.

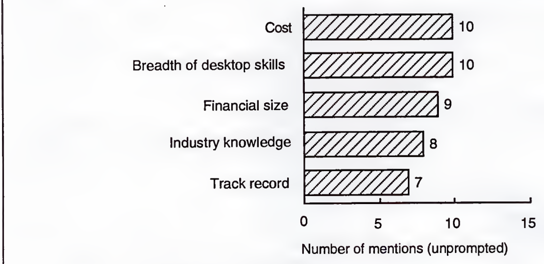
IT Managers Seek Low Cost and Strong Technical Skills

The key criteria that IT managers would use in selecting a vendor for desktop services are listed in Exhibit 3.

IT managers perceive that desktop services outsourcing is primarily concerned with cost reduction. While organisations often desire improved user productivity from desktop services outsourcing, they remain typically unlikely to raise their support costs to attain this goal.

Exhibit 3

Vendor Selection Criteria
IT Managers



Sample of 51 IT managers

Source: INPUT

The vendor's comparative level of technical skills is another critical criterion for IT managers. Ideally, IT managers are seeking a vendor with an extensive desktop services portfolio, together with depth of technical capability within each of these services. However, IT managers are typically not enthusiastic about potential desktop services suppliers having a wider IT infrastructure capability, such as the ability to manage mainframe data centres.

Although not shown in Exhibit 3, another important selection criterion is the vendor's geographic coverage. This is particularly important where organisations require an element of on-site support. IT managers want vendors to match the existing, and projected, geographic spread of their own organisations. In many cases, this implies extensive national coverage by the vendor. However, in some instances, organisations now require vendors that can offer European, or even global, coverage.

Users Require a Business Contribution and High Service Levels

Exhibit 4 lists the key vendor selection criteria cited by users.

The key differences between the selection criteria adopted by IT managers and those adopted by users are as follows:

- Users appear to place much less emphasis on cost, though vendors should not rely on CFOs taking a very different attitude than that exhibited by IT managers.

- Users place considerable emphasis on the vendor's understanding of their business and the contribution that the vendor can make to assisting the organisation meet its business objectives. IT managers tend to be more concerned with technical competence.

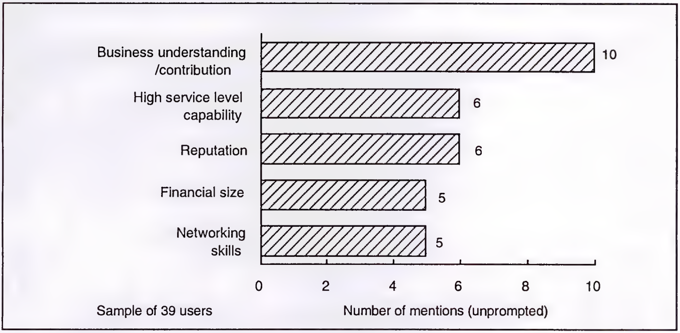
- Many users require a vendor that can offer higher service levels than those they have been accustomed to receive in the past.

In addition there are several criteria mentioned by users that, while potentially important, are not shown in Exhibit 4. Firstly, some users place an emphasis on the vendor having multi-vendor platform expertise and stress the importance of the vendor being independent of any individual equipment vendor.

Secondly, some users stress the importance of flexible contracts. By *flexible*, users mean short-term contracts which do not lock them into a particular vendor or equipment base.

Exhibit 4

Vendor Selection Criteria: Users



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Vol. V, No. 9

May 1994

Vendor Positioning in the Outsourcing Market

The outsourcing market used to be regarded by vendors as a very homogeneous market in which it was very difficult to differentiate one organisation from another. However, as the outsourcing market has matured, so the segmentation of the market has increased and vendor positioning has diverged.

This segmentation differs significantly from that in the project services market. In the project services market, industry and application knowledge are key differentiators. However, in the outsourcing market, industry focus remains a comparatively minor positioning parameter. The major vendor positioning parameters in the European outsourcing market are the:

- Scope of the vendor's IT infrastructure operational capability
- Degree of emphasis placed on re-engineering
- Extent to which vendors sell in partnership with IT managers.

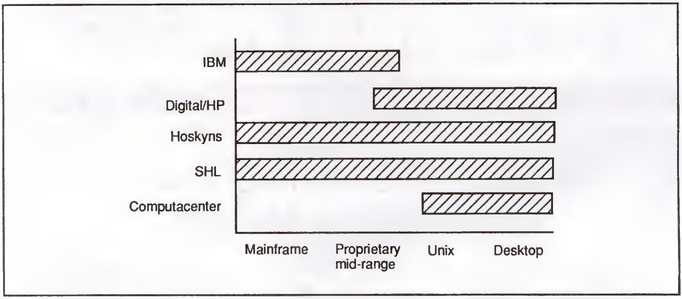
One result of this segmentation, is that the equipment vendors, who are often regarded as a homogeneous group of suppliers, exhibit a considerable divergence of positioning within the European outsourcing market.

Scope of Operational Management Capability

The scope of their infrastructure management capability is indicated for a number of vendors in Exhibit 1.

Exhibit 1

Infrastructure Management Capability



Source: INPUT

A large component of the European outsourcing market has traditionally been focused on assisting organisations make the transition from a mainframe-centred IT infrastructure to a more distributed environment. At first, the new environment was often based on stand-alone mid-range equipment such as IBM AS/400s. However, organisations are now increasingly moving towards a client/server architecture, and placing more emphasis on desktop computing.

As a result, many organisations that have already outsourced the operation of their mainframe datacentres now seek vendors to manage their distributed systems and desktop environments. In addition, some organisations are now independently outsourcing the operation of their client/server and desktop infrastructures.

Vendors can be broadly classified into those with datacentre capability, those with Unix-based and desktop system capability, and those with operational capabilities in both of these areas.

Those with predominantly mainframe datacentre capability include IBM, EDS, and CSC. Although EDS has established its Technical Products Division (TPD) in Europe to serve the desktop services market, TPD has a greater emphasis on product distribution than on true outsourcing services such as LAN management.

Infrastructure outsourcing deals with major organisations involving a significant element of mainframe datacentre outsourcing, are likely to be dominated by the economics of datacentre outsourcing. Clients will tend to favour vendors that have significant mainframe outsourcing capability in-house rather than vendors with extensive client/server and desktop management capability who may need to use partners for access to datacentre operations capability.

Vendors with predominantly Unix-based systems management and desktop services capabilities include Digital, Hewlett-Packard, and the major PC dealers such as P&P and those represented by the International Computer Group.

Vendors that have established a comprehensive IT infrastructure capability include Hoskyns, debis Systemhaus, SHL Systemhouse and ITnet. However, ITnet remains a comparatively minor player in the outsourcing market and will have difficulty in utilising its all-round infrastructure management capability in major outsourcing contracts because of its size and limited geographic scope.

Emphasis on Re-engineering

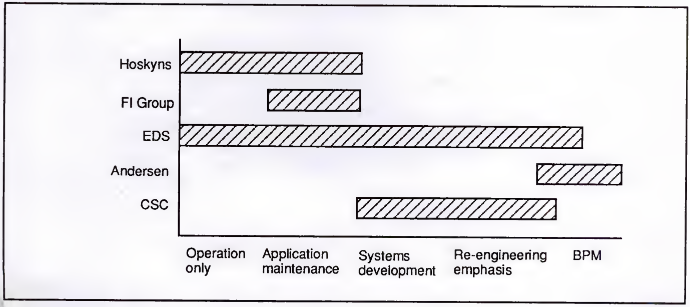
Exhibit 2 illustrates the degree of emphasis placed on re-engineering by a number of leading outsourcing vendors.

The vendors that place the greatest emphasis on their business re-engineering capability are CSC, EDS, Perot Systems and Andersen Consulting. Indeed, Andersen Consulting takes comparatively little interest in the mainstream IT outsourcing market. Historically, the company has tended to become involved in transition outsourcing in support of major systems integration projects. More recently, Andersen Consulting has targeted the business operations sector, specifically accounting functions within oil companies operating in the North Sea.

EDS has also begun to target the business operations sector in Europe. The company has contracts with two municipal authorities for parking fine collection and with Time Life for its fulfilment function.

Exhibit 2

Re-engineering Emphasis



Source: INPUT

CSC and Perot Systems have not yet begun to offer business operations outsourcing. However, they are amongst the leaders in stressing their ability to aggressively apply IT in support of their clients' business processes. Perot Systems is redeveloping the operational systems of Europcar and East Midlands Electricity, while CSC's re-engineering capability was instrumental in the company being awarded the BhS outsourcing contract. EDS' ability to apply the latest retailing technology was a major factor in winning the KF contract.

Amongst the European outsourcing vendors, GSI has considerable development expertise in the distribution sector. However, the majority of European vendors place a greater emphasis on their operational management and technical capabilities than on their ability to support business re-engineering within the client.

Hoskyns' outsourcing portfolio is a good example of this. Hoskyns' outsourcing service lines consist of:

- Centralised computing services
- Distributed computing services
- Applications management
- Network services
- Desktop support.

Although Hoskyns also has considerable business integration expertise and is now starting to take a more industry-centred, rather than service-centred, approach to the market, the company remains technically oriented in the outsourcing market. In particular, the company considers its technically oriented application management and distributed computing services to be the key growth opportunities in the immediate future.

Partnership with IT Managers

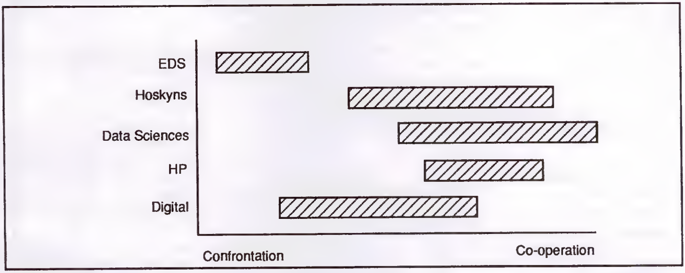
Exhibit 3 illustrates the extent to which the named vendors co-operate with IT managers in selling their services rather than seeking to compete with them in a more confrontational manner.

This parameter tends to have a strong, inverse correlation with the degree of emphasis placed on business re-engineering. However, not all of the contracts won by CSC and EDS have a strong re-engineering emphasis. In particular, the size of the capital injection from the outsourcing vendor was a key factor in CSC's recent contract with BAe, and the Inland Revenue contract was strongly influenced by financial considerations. Nonetheless, the approach of EDS and CSC is primarily oriented towards board members rather than IT directors and managers.

This is not the only successful tactic within either the central government sector or the overall European outsourcing market. Within the UK central government market testing exercise, the majority of large contracts are being awarded to external vendors. However, the majority of the smaller contracts are being won by the in-house service provider. In response to this situation, Data Sciences has decided on a strategy of partnering in-house service providers rather than competing with them in the manner of EDS, CSC, and IBM.

Exhibit 3

Degree of Co-operation with IT Managers



Source: INPUT

In many respects, Hewlett-Packard is adopting a similar strategy with *Selective Outsourcing*. In this instance, the company is endeavouring not to compete openly with IT managers, but to persuade them that they should concentrate their department's efforts on systems development while Hewlett-Packard handles the operational management of their open systems and desktop infrastructures.

Similarly, Hoskyns' outsourcing service lines are designed to take into consideration the service elements that IT managers are most prepared to outsource. Their early entry into the application maintenance market is a good example of this, as was their earlier *Crossroads* service.

The size of contract targeted is another important positioning criteria in addition to those listed above. From the client's perspective, it is primarily the size of the prospective vendor's outsourcing operation and the size of their existing contracts that are important not the overall vendor revenues. Because outsourcing deals tend to be smaller, and for shorter periods, in Europe than in the US. This provides the major US-based vendors with a significant advantage in targeting contracts valued in excess of $100 million. Accordingly vendors such as EDS and Perot Systems tend to focus on the larger contracts, while most of the European vendors continue to concentrate on contracts in the $2 million to $50 million range.

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Research Bulletin

A Publication from INPUT's Outsourcing Information Systems Programme – Europe

Vol. V, No. 10

June 1994

Geographical Coverage and Breadth of Technical Capability are Success Factors in Desktop Services Outsourcing

Clients still have difficulty in identifying vendors with a broad range of infrastructure management capability. However, it is increasingly difficult to detect outsourcing vendors that are not now targeting desktop services outsourcing. The major PC dealers such as members of the International Computer Group (ICG) and P&P were among the first vendors to demonstrate the potential of desktop services outsourcing. However, these vendors have now been joined in the market by:

- Equipment vendors such as Hewlett-Packard and Digital
- Major North American professional services vendors such as EDS and SHL Systemhouse
- European professional services vendors such as Cap Gemini Sogeti and Sema Group
- Independent maintenance companies such as Thomainfor and Computeraid.

The result is a wide variation in approaches and vendor positioning. This variation in positioning can be analysed in terms of vendors':

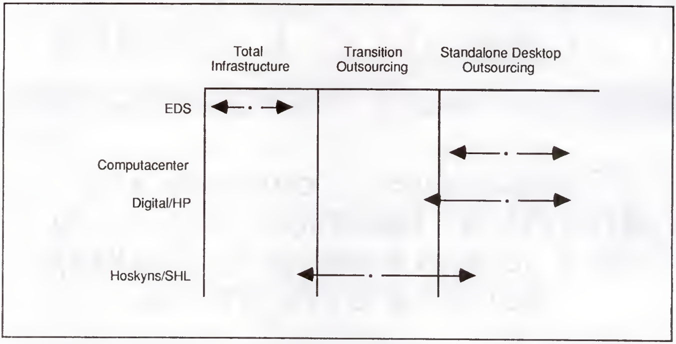
- Approach to IT infrastructure management
- Support coverage
- Sales style and size of organisation targeted.

Approach to Infrastructure Management

There are essentially three different approaches that vendors can take in targeting desktop services outsourcing. These approaches are summarised in Exhibit 1.

Exhibit 1

Approach to Infrastructure Management



Source: INPUT

Firstly, vendors can target desktop services outsourcing as a component of major contracts where the vendor expects to assume responsibility for the major part, if not all, of the client's IT infrastructure. Application development may also be included in these contracts particularly where they are driven by a strong emphasis on business re-engineering. In these cases, contract negotiation will tend to be dominated either by the financial considerations centred around the transfer of existing mainframe facilities or by the vendor's perceived ability to improve the client's application of IT to the business.

In either case, the vendor's ability to manage desktop systems is unlikely to be a major element of the decision process. Accordingly, it will be easier for a vendor with extensive mainframe systems operations capability to act as prime contractor and introduce partners for desktop services outsourcing than vice versa.

One example of a vendor operating primarily in this manner is EDS. Although EDS has created a business unit, namely Technical Products Division (TPD), to target the desktop environment, TPD in Europe is concentrating on product sales and installation services rather than outsourcing services. In particular, TPD is not building up the technical infrastructure to manage large numbers of stand-alone desktop services outsourcing contracts. EDS appears more likely to introduce client-specific desktop services delivery mechanisms as the result of winning major outsourcing contracts that involve an element of outsourced desktop services.

At the other extreme are organisations such as the members of ICG. These vendors typically only possess the capability to manage open systems and PC based infrastructures. Accordingly they are dependent for their success on either targeting medium-sized organisations or persuading large organisations to separately outsource their desktop services. So far they have been reasonably successful with this latter approach.

Another approach to winning desktop services contracts is via transition outsourcing. This approach is being widely practised by organisations such as Hoskyns and SHL Systemhouse. Approximately a quarter of organisations that undertake downsizing in which the mainframe is replaced use an outsourcing vendor to assist them in phasing out the mainframe services. Subsequently many of these organisations decide that they should outsource the day-to-day management of their new IT infrastructures. This approach is also favoured by IBM ISSC in France, which is currently having difficulty generating revenues from the standalone desktop services outsourcing market.

Support Coverage

Two of the principal vendor selection criteria in the desktop services outsourcing market currently are the ability of the vendor:

- To supply a complete range of desktop services
- To match the geographic coverage of the client organisation.

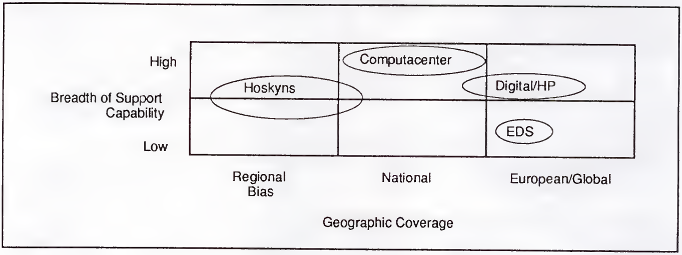
Those organisations that have undertaken desktop services outsourcing already, such as TSB, United Distillers, and SG Warburg have typically done so because of the difficulty of providing consistent service levels via an in-house support unit. These difficulties have often arisen because of the wide geographic spread of the organisation, as is the case with TSB and United Distillers. Alternatively, as is the case for SG Warburg, the organisation may require high and consistent levels of support across a wide range of desktop disciplines because of the critical role played by desktop systems in supporting the organisation's business processes.

Consequently, many of the early desktop services outsourcing contracts have been won by the vendor that has best been able to demonstrate a specialist knowledge across the range of desktop support functions combined with a branch network matching the client's own geographic spread.

The perception of the positioning of a number of leading vendors against these criteria is shown in Exhibit 2.

Exhibit 2

Support Coverage



Source: INPUT

At this stage in the development of the desktop services outsourcing market, clients' requirements are typically for extensive national coverage rather than pan-European or global coverage. On this basis, the national PC dealers such as Computacenter are well positioned.

This group of vendors are also recognised as desktop technology specialists with the ability to handle a wide range of services including for example maintenance, and detailed help-desk support. The need to outsource some elements of desktop services such as maintenance is a weakness for many of the professional services vendors operating in this market, as is their comparatively limited number of national support offices. Hoskyns can reasonably claim pan-European co-ordination of its desktop services offering through its fellow subsidiaries, but its regional presence in the U.K. may still appear limited to clients used to local equipment maintenance support for their desktop systems.

While Computacenter can also provide pan-European outsourcing services through its membership of ICG, this has not so far been a successful approach to the market. The vendors that are perceived to be clearly pan-European in their approach to the market are the equipment vendors and the leading North American professional services vendors.

However vendors such as EDS and CSC have yet to build up a comparable breadth of desktop services capability in Europe.

Sales Style and Size of Organisation Targeted

Another key aspect of vendor positioning is the size of organisation they target. This is summarised for a number of vendors in Exhibit 3.

Exhibit 3

Size of Organisation Targeted

Vendor	Large	Medium
EDS	X	
Digital/HP		X
SHL	X	X
Computacenter	X	X

Source: INPUT

EDS are targeting the major organisations and tend not to address the smaller outsourcing opportunities within medium-sized organisations. Their approach is primarily directed towards the senior executives in the target organisation rather than the IT management.

Digital and Hewlett-Packard, on the other hand, recognise the difficulty of targeting major outsourcing contracts that are likely to be dominated by the mainframe systems operations. Accordingly, they are tending to concentrate on medium-sized organisations or individual units within large organisations.

In addition they are targeting IT managers in an endeavour to persuade them to define their own core competence and outsource day-to-day operational management of client/server and desktop systems to an external supplier. So far, the majority of desktop services outsourcing contracts appear to be being generated via IT managers with the vendor being chosen on the basis of relatively technical decision criteria.

SHL Systemhouse and Computacenter are targeting both large and medium-sized organisations. SHL Systemhouse is targeting them with its transformational outsourcing offering which includes mainframe datacentre management while Computacenter endeavours to generate stand-alone desktop services outsourcing sales regardless of size of organisation.

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Vol. V, No. 11 June 1994

Increase in Strategic Outsourcing Favours Vendors

The Computing Services Association (CSA) in the U.K. is currently concerned that market testing exercises within central government departments are biased in favour of the in-house service provider.

In a survey conducted by the CSA, its members had withdrawn from the market testing process on 44% of occasions, because they judged that they had no worthwhile chance of competing for the business against the in-house unit. However in spite of these complaints, U.K. central government departments will remain a major source of revenues for outsourcing vendors during the life of the current government. The government remains committed to market testing and the Efficiency Unit still requires government departments to submit market testing targets.

The government initially planned to market test activities valued at $2.2 billion per annum by September 1993. At end December 1993, activities valued at $1.6 billion per annum had been market tested. The government remains committed to market testing the remainder of this initial programme and to carry out a new programme of market testing covering activities valued at a further $1.2 billion per annum.

At present, the available evidence suggests that:

- Large contracts are biased in favour of the external vendor
- In-house service providers tend to win the majority of smaller contracts
- There is increasing scope for vendors to partner in-house service providers.

Large Contracts Are Biased in Favour of External Vendors

The evidence shown in Exhibit 1 suggests that vendors have very high expectations if they perceive that the overall market testing programme is biased in favour of the in-house department.

Exhibit 1

Results of 1992-93 Competing for Quality Programme

Results of Test	Pre-test Value of Activities ($M)	Number of Tests	Pre-test Number of Civil Service Posts	Reduction in Posts
Contracted Out (No In-house Bid)	1,136	113	14,722	10,801
Contracted Out (In-house Bid)	129	82	1,591	1,054
In-house Win	280	147	7,086	1,713
Privatised	37	3	441	436
Untied	18	6	144	33
Withdrawn	22	13	409	153
Abolished	34	25	753	397
Total	1,655	389	25,146	14,587

Source: The Citizen's Charter, HMSO

Exhibit 1 summarises the results of market tests conducted in the period ending 31 December 1993. It shows all market tests regardless of business function. However there is no reason to suppose that the profile of results is markedly different for IT-related market testing.

In theory, market testing provides for a comparison of the relative value for money provided by the in-house supplier and by external suppliers. In practice, the present government wishes to reduce the size of the civil service and would be embarrassed by in-house service providers achieving high overall levels of success. The result is that 70% by value of the activities market tested in 1993 were contracted out as a result of a strategic decision to employ an outside supplier. No in-house bid was permitted in these cases.

Because of the nature of the incentives to ministers, the decision not to allow an in-house bid is typically taken for the largest contracts. In the case of the IT function, strategic decisions have been taken to outsource within the Export Credits Guarantee Department, ITSA, (the Department of Social Security's IT agency) and the Inland Revenue. In addition, DVOIT (formerly the Driver and Vehicle Licensing Authority's information technology arm), has been privatised, which achieves the same objective by a slightly different route. The CCTA expects the use of strategic outsourcing to increase over the next two years.

The size of some of these contracts has mitigated against indigenous suppliers, however. The only two outsourcing vendors that the CCTA regards as large enough to manage the Inland Revenue contract for example are EDS and CSC. Since the Government cannot afford the embarrassment of having a key market test fail, the selection criteria are particularly risk averse, again favouring the large U.S. based outsourcing vendors.

Examples of some of the major IT outsourcing contracts awarded by central government departments are listed in Exhibit 2.

Exhibit 2

Contracts Awarded

Department	Vendor	Contract Value ($M)
Inland Revenue	EDS	1,500
Operations West	Hoskyns	70
DVOIT	EDS	35
Export Credits Guarantee Department	Data Sciences	15

Source: INPUT

In-house Service Providers Win the Majority of Smaller Contracts

Overall, in-house departments won 68% by value of those contracts for which they were allowed to compete. The average value of these contracts was $1.8 million. The proportion is estimated to be similar for IT services. The CCTA estimates that approximately 60% of IT-related market tests in which the in-house IT department was allowed to compete, have been won by the in-house IT department.

Overall, it appears that the majority of contracts valued at over $5 million are being won by external vendors, and the majority of contracts below $5m in value are being won by the in-house service provider. There are several factors contributing to this situation.

Firstly, the political desire to outsource declines with falling contract value and falling number of civil servants involved. Secondly, many of the smaller IT functions that are market tested will already have undertaken internal efficiency reviews and substantially reduced their costs and headcounts. This can make it difficult for outside vendors to demonstrate improved value for money while making a profit over the life of the contract.

Other government departments are also a potential source of competition. The Chessington payroll unit, part of the Office of Public Service and Science, has been particularly successful, recently beating CMG to a contract to provide payroll services to the Department of Employment.

Accordingly, if vendors decide to bid in their own right for these smaller contracts, they need to develop low cost screening mechanisms that will enable them to assess their chances of success at an early stage in the sales process.

Vendors Are Actively Partnering with In-house Service Providers

However, vendors do not necessarily need to bid in opposition to the in-house service provider. Vendors have a choice of approach in targeting market tests. They can either be a bidder in their own right or they can act as a supporter of the in-house bid team. In practice, many in-house service providers will wish to partner with an external vendor that can assist them in developing their commercial skills and help them to overcome any shortfalls in technical capability.

Examples of the bidders for a number of market tests currently in progress are listed in Exhibit 3.

Exhibit 3

Market Tests in Progress

Department	Bidders
Department of Trade and Industry	In-house/Data Sciences Hoskyns/ICL Capita/Admiral
Home Office	In-house/Hoskyns Sema Group
Department of Employment	In-house Sema Group EDS

Source: INPUT

Data Sciences, in particular, is adopting a strategy of partnering with in-house service providers. The company does not wish to extend its current base of datacentres in the U.K. However, Data Sciences perceives that it is in a strong position to strengthen in-house bids both by complementing the skills of the in-house service provider and in improving the efficiency of the government department's datacentre by attracting additional external business there.

On the other hand, Sema Group is bidding for the Home Office data centre in Bootle and the Department of Employment data centre in Runcorn partly because the company wishes to acquire a data centre in the north west of the country.

In the high value market testing exercises, consortia appear to have been at a disadvantage over individual service providers. However, the CCTA claim that there is no built-in prejudice against consortia formed to bid for market testing contracts. In practice, the CCTA will encourage market testing units to analyse the strengths and weaknesses of each member of a consortium and to assess how well the parties can be expected to work together. Accordingly, established partnerships tend to be favoured over newly formed associations. In particular, where in-house service providers are using a partner to support their bid, the reasons for using a partner and the two parties' compatibility will be important elements in the selection criteria.

The key stages within a market test are as follows.

Firstly, vendor responses to the initial advertisement are analysed in broad terms, covering the vendors' track record, financial standing, and technical capability. At this stage the shortlist is typically reduced to eight or nine vendors.

These vendors are asked to quote against the detailed requirement with two or three vendors being selected for detailed negotiations. At this stage, service level agreements and pricing structures are established, and reference visits conducted. Pricing structures are important since the government wishes to convert fixed costs to variable costs based on declining resource usage.

Assuming that these negotiations are satisfactory, technical sign-off is established, and the remaining vendors are asked to submit best and final offers. From now on the assessment process is essentially a financial appraisal and the vendor will be selected that offers best value for money.

It is recognised within the CCTA that those vendors that have been successful in winning market testing contracts have generally been prepared to lose money in the early years of the contract. However, the CCTA expects that subsequent changes to the contract in its later years will enable vendors to restore contracts to profitability.

The most prevalent criticism of the market testing process made by CSA members is that market testing specifications tend to describe the method of current delivery rather than the output that is to be delivered. Certainly, the market testing process is a conservative one that places considerable emphasis on the vendor's track record and financial strength. As such it will tend to favour the major suppliers and tend to discourage innovation.

In addition, the pattern of market testing remains hard to predict. The Department of Employment is market testing its data centre, while the Department of Trade and Industry is market testing its:

- ICL data centre
- Mid-range equipment and desktop services
- WANs and LANs
- Software development.

As an alternative approach, the Ministry of Agriculture and Fisheries is market testing its IT on an application by application basis.

So far, there has been little business operations market testing within central government.

However, overall there is an increasing propensity for government departments to include system development within the scope of market testing exercises.

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Research Bulletin

A Publication from INPUT's Outsourcing Information Systems Programme – Europe

Vol. V, No. 12

June 1994

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Role of Information Technology is Stimulated by Business Re-Engineering

The emphasis of business re-engineering[1] is on revolutionary approaches to the organisation's market rather than on incremental improvements to existing ways of doing business.

Vendors have seized on business re-engineering as a means of initiating new IT projects and as a means of capturing these projects at an earlier stage in their evolution. This has led to the acquisition or formation of management consulting divisions within a number of leading vendors.

However, the application of business re-engineering techniques is potentially a double-edged sword that could lead to significant simplification of an organisation's use of information technology, and reduced IT expenditure.

Hence it is necessary to address the question of how senior executives view the roles of business re-engineering and IT within their organisations. Overall , senior executives in Europe perceive that:

- Improving the efficiency of individual processes is the primary benefit achieved by business re-engineering
- Better application of IT is more important than reducing IT expenditure
- IT can make a major contribution to business re-engineering.

A number of recent, major IT outsourcing projects in Europe have apparently been strongly influenced by the successful vendor's business re-engineering capability. This is the first of a series of research bulletins analysing

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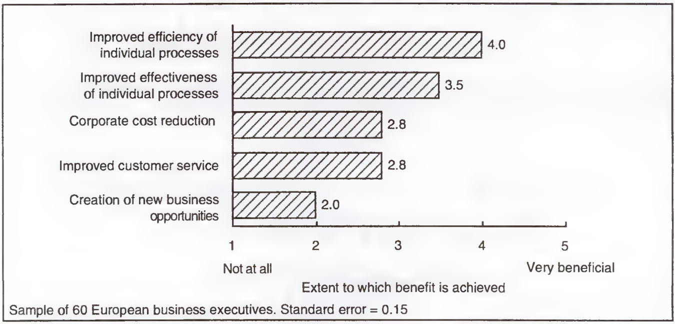
[1] Business process re-engineering (BPR) is defined as: "*A means of achieving radical improvement in business performance and competitiveness through a re-evaluation and redesign of core business processes.*"

Exhibit 1

Benefits of Business Re-engineering



Sample of 60 European business executives. Standard error = 0.15

Source: INPUT

the impact of business re-engineering on the European IT outsourcing market.

Improving the Efficiency of Individual Processes

Exhibit 1 shows the extent to which senior executives perceive that business re-engineering can deliver a number of potential benefits.

Overall there is a high level of awareness of business re-engineering amongst executives in Europe, though some executives in France expressed a lack of knowledge of the topic. The principle of business re-engineering was acknowledged to be a good one though some doubts were expressed regarding the feasibility of translating the principle into practice.

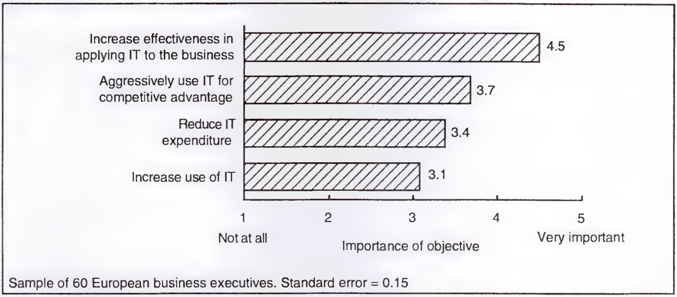
The most positive attitudes to business re-engineering were expressed in Germany. Business re-engineering is often discussed in terms of shortening value chains, reducing product or service lead times and improving customer service.

However, business re-engineering is principally viewed in Europe as a means of achieving increased efficiency through cost savings and reduced numbers of personnel involved in key business processes. A consistent theme across Europe is that business re-engineering should be applied to processes with a high labour content. Processes that had a major impact on inventory levels were also regarded as initial targets for business re-engineering.

Overall European executives have an inward-facing attitude towards business re-engineering. They expect business re-engineering to deliver improved process efficiency but have low expectations of it

Exhibit 2

Corporate IT Objectives



Sample of 60 European business executives. Standard error = 0.15

Source: INPUT

delivering improved customer service or creating new business opportunities.

Improved Application of IT is More Important than Cost Reduction

Exhibit 2 shows the importance senior executives attach to each of a number of potential corporate IT objectives.

In recent years there has been considerable dissatisfaction with the low levels of business benefit that have often resulted from major IT investments. This has led to greater involvement of senior executives in authorising IT projects and a more critical approach to the application of IT. It has also led to considerable pressure on in-house IT departments to reduce their budgets.

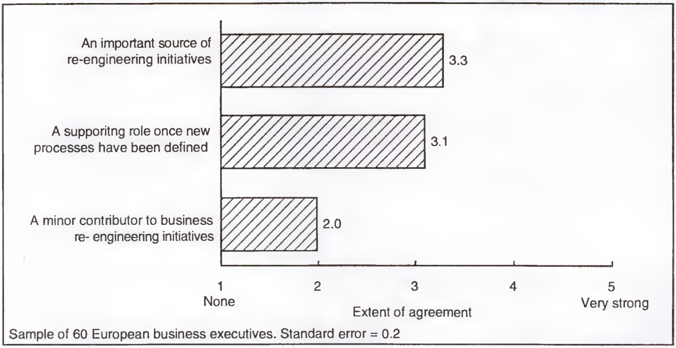
However, while there remains some pressure on IT departments to reduce their levels of expenditure, there is now an increasing recognition of the possibility of using IT aggressively by senior executives.

Overall senior executives wish to maintain their level of use of IT but are seeking considerable improvement in the manner in which IT is applied to their business.

There is agreement among executives in each of France, Germany, and the U.K. on the need to increase the effectiveness with which IT is applied to their businesses. However, executives in Germany display a comparatively high level of intent to use IT for competitive advantage. On the other hand, executives in France display a greater concern with reducing their organisation's IT expenditure than using IT for competitive advantage.

Exhibit 3

Role of Information Technology within Business Re-engineering



Sample of 60 European business executives. Standard error = 0.2

Source: INPUT

IT Expected to Make Major Contribution to Business Re-Engineering Initiatives

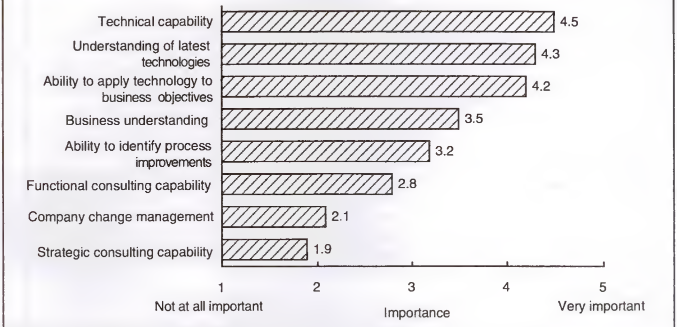
Exhibit 3 analyses executives' perceptions of the role played by IT within business re-engineering exercises.

Overall executives agree that information technology plays an important role within business re-engineering projects. However executives are divided on the nature of information technology's role. Approximately 55% of the executives perceived that IT should play a pro-active role and had the potential to be an important source of business re-engineering initiatives. On the other hand, approximately 45% of executives perceive that information technology should not directly influence the nature of business re-engineering projects but should act to facilitate the implementation of new processes once these have been defined.

There are significant differences in attitude on this point between executives in each of France, Germany, and the U.K. In France, executives frequently regard IT as inseparable from business re-engineering. Consequently, French executives tend to believe that IT is an important driving force behind business re-engineering projects. In the U.K., executives tend to be more dismissive of the role of information technology as a driving force for business re-engineering and regard technology largely as a supporting tool for assisting in new process implementation.

Exhibit 4

Perceived Importance of Supplier Skills



Sample of 60 European business executives. Standard error = 0.15

Source: INPUT

Overall, executives expect their IT suppliers to be technology experts rather than strategic consultants. Their perceptions of the relative importance of a number of skills are shown in Exhibit 4.

However, there are again significant differences between countries. German executives expressed a comparatively strong desire for vendors to be able to identify process improvements and to possess functional consulting capability.

On the other hand, the desire of U.K. executives to separate responsibility for business process design from technical issues is reflected in their attitudes towards the skills their IT suppliers should possess. Executives in the U.K. typically require only very limited business understanding from their suppliers.

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Vol. V, No. 13

July 1994

Outsourcing Provides Indirect Support for Business Reengineering

IT outsourcing is frequently associated with business reengineering. Many outsourcing contracts have apparently been initiated by organisational restructuring exercises and others by the need to rebuild critical information systems and provide improved information technology support for the business. Outsourcing is beginning to be seen as a real threat to the continued growth of the systems integration market, as large development projects increasingly arise in an outsourcing rather than a project context.

However, there is an alternative model that states that outsourcing is primarily concerned with improving an organisation's core business focus. On this basis, only secondary, non-core activities should be outsourced, excluding, presumably, any activities that make a major contribution to business re-engineering initiatives.

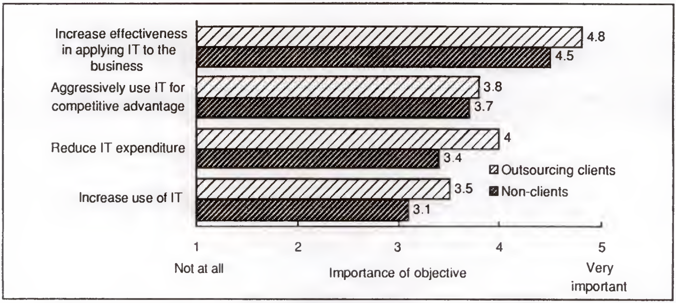
In the first of these models, outsourcing is a key instrument in the implementation of business reengineering; in the second, it is essentially a cost reduction tool for organisations that place a low priority on their use of information technology.

A key question is, "Which , if either, of the models applies to Europe?" Research indicates that the majority of situations occupy a position between these two extremes. In practice, executives within organisations that have adopted IT outsourcing typically:

- Are enthusiastic about applying information technology to their business
- View information technology as an important source of reengineering initiatives
- Perceive outsourcing and reengineering to be culturally highly compatible, but view IT outsourcing to mainly provide indirect support for reengineering initiatives.

Exhibit 1

Corporate IT Objectives



Sample of 30 executives within outsourcing clients and 60 within non-clients. *Standard error = 0.2 Source: INPUT*

Outsourcing Clients are Enthusiastic about Information Technology

Exhibit 1 provides evidence to refute the suggestion that organisations that adopt IT outsourcing are less enthusiastic about the application of information technology than organisations that retain their entire IT function in-house.

Approximately 60% of executives in both types of organisation strongly perceive the pro-active use of information technology to be important. Similarly, the overwhelming majority of executives strongly believe that it is important to increase the effectiveness with which information technology is applied to their business. Perhaps surprisingly, executives within organisations that already use IT outsourcing are significantly more committed to increasing their use of IT than their counterparts. However, these executives are simultaneously strongly committed to reducing their organisation's IT expenditure.

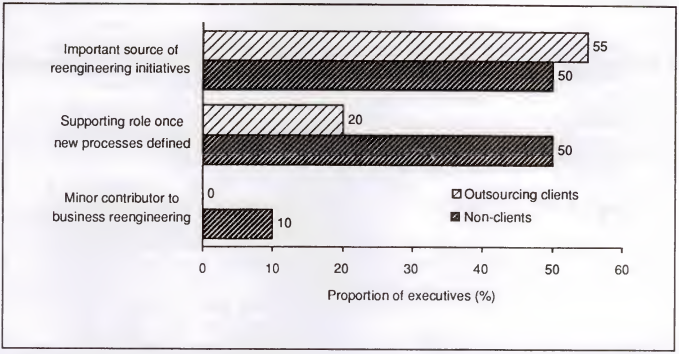
In terms of overall objectives, organisations that have adopted IT outsourcing are as equally committed as other organisations to gaining business benefit from information technology, and may be more likely to extend their use of information technology. However, executives in these organisations typically want to achieve these objectives while simultaneously reducing costs.

IT Viewed as Important Source of Reengineering Initiatives

Exhibit 2 shows European executives' perceptions of the role of information technology within reengineering.

Exhibit 2

Role of IT within Business Reengineering



Sample of 30 Outsourcing clients and 60 non-clients.
Proportion of executives giving a score of 4 or 5.

Standard error = 10% Source: INPUT

Contrary to their public image, European executives are often enthusiastic about the role of information technology within business reengineering initiatives. The majority of executives in France and Germany, within organisations that have not adopted IT outsourcing, strongly perceive information technology to be an important source of reengineering initiatives. However, executives in the U.K. are more hostile to information technology and only a quarter of executives share this view.

Executives within organisations that have already adopted IT outsourcing are more enthusiastic about the role of information technology than their counterparts.

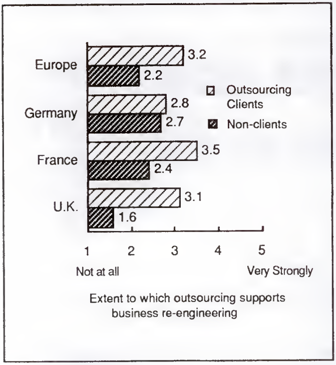
None of the executives in organisations already outsourcing regarded information technology to be only a minor contributor to reengineering and only 20% of them strongly perceived information technology to play primarily a supporting role rather than a pro-active one.

Outsourcing and Reengineering Perceived to be Culturally Compatible

Exhibit 3 identifies the extent to which outsourcing is perceived to support business reengineering by country.

Exhibit 3

Outsourcing and Business Reengineering



Sample of 30 outsourcing clients and 60 non-users. Standard error = 0.2. *Source: INPUT*

Overall, outsourcing clients take a much more favourable view of IS outsourcing's ability to support business reengineering than do executives in general. The majority (55%) of executives, within organisations that have already adopted IT outsourcing strongly perceive IT outsourcing to be supportive of business reengineering. In contrast only a minority of executives (25%) in organisations that have not adopted IT outsourcing perceive it to strongly support reengineering.

The views of executives in organisations that have not adopted IT outsourcing differ significantly by country. Approximately a third of executives within this type of organisation in France and Germany believes there to be strong links between outsourcing and business reengineering. On the other hand, executives in the U.K. are almost unanimous in dismissing the relevance of IT outsourcing in supporting business reengineering. However, this negative perception of executives in the U.K. is not limited to outsourcing. These executives take a much more negative view of the relevance of information technology to reengineering than do their counterparts in France and Germany.

Information technology is typically perceived to play a pro-active role within reengineering projects. However, while executives within organisations using IT outsourcing exhibit high levels of enthusiasm for the application of information technology, they characteristically perceive IT outsourcing to provide indirect rather than direct support for reengineering projects.

In particular, outsourcing and reengineering are perceived to share a similar management philosophy that places a major emphasis on:

- Cost reduction
- Core business focus
- Increased organisational flexibility.

Both outsourcing and reengineering aim to reduce the numbers of personnel directly employed in labour-intensive activities. Indeed one of the outcomes from business reengineering exercises will often be the decision to outsource certain activities.

Outsourcing is also perceived to be supportive of business reengineering by removing management involvement removing management involvement from an area of day-to-day activity. This consequently frees management resources to concentrate on reengineering initiatives.

Finally IT outsourcing is viewed as supporting reengineering by removing one of the potential obstacles to change within the organisation, and, at the same time, demonstrating to the rest of the organisation that it is possible to successfully transfer an in-house activity to an external vendor.

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Vol. V, No. 14 July 1994

Outsourcing Vendors Must Improve Support for Business Reengineering

The majority (80%) of business executives perceive it to be important that their IT department or outsourcing vendor has the capability to support reengineering initiatives. However, only 50% of executives believe that their *IT department or outsourcing vendor* is currently well qualified to provide this support.

Consequently, IT outsourcing vendors can achieve competitive differentiation through their pro-active participation in business reengineering initiatives. To achieve this aim, vendors must:

- Demonstrate that their capability to support business reengineering exceeds that of the organisation's own IT department
- Persuade executives of their ability to contribute to the identification and definition of new business processes
- Demonstrate the impartiality of their advice and their ability to respond quickly to changing client needs.

IT Departments Equal Vendor Capability to Support Business Reengineering

Exhibit 1 compares executives' views of the importance of support for business reengineering with the perceived capability of their outsourcing vendor or IT department to provide this support.

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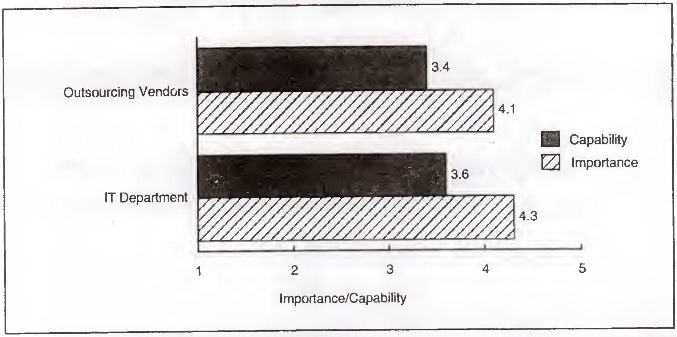
Exhibit 1

Capability of Outsourcing Vendors and IT Departments to Support Business Reengineering Initiatives



Sample of 30 executives in organisations using IT outsourcing and 60 executives in organisations not using IT outsourcing. Standard error = 0.2.

Source: INPUT

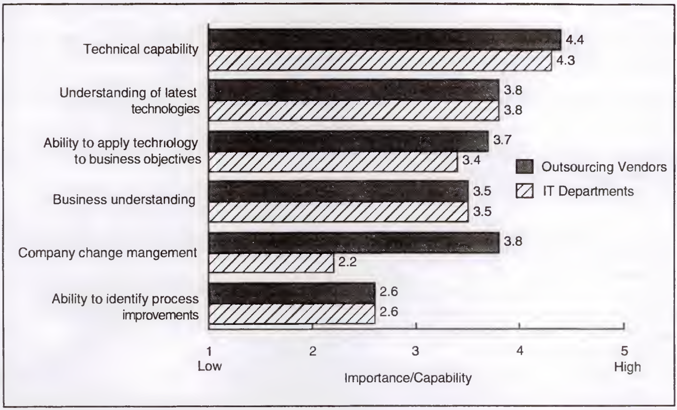
The previous research bulletin in this programme (Vol.V, No. 13) indicated that executives within organisations that have adopted IT outsourcing typically want to use information technology pro-actively in support of their business goals. However, at present, they only view IT outsourcing as a form of indirect support for business reengineering.

A major reason why they adopt this view could be the perceived inability of outsourcing vendors to provide high calibre support for reengineering. Indeed, both IT departments and outsourcing vendors are perceived to have a similar shortfall in overall capability to support business reengineering initiatives.

Executive perceptions of the detailed capabilities of IT departments and outsourcing vendors are compared in Exhibit 2.

Exhibit 2

Perceived Capabilities of IT Departments and Vendors



Sample of 30 executives in organisations using IT outsourcing and 60 executives in organisations not using IT outsourcing. Standard error = 0.2.

Source: INPUT

Overall, the capability profiles of IT departments and outsourcing vendors are perceived to be very similar. Both are typically perceived to have high levels of technical capability and a reasonable understanding of the latest technologies. This latter perception should concern outsourcing vendors since one of their major selling points is supposedly their ability to assimilate new technologies at a faster rate than in-house IT departments. However, only 60% of the executives interviewed perceived their outsourcing vendor to have a good understanding of the latest technologies. This may reflect the difficulties some vendors have experienced in adding desktop services to their service portfolio. INPUT's satisfaction survey of outsourcing clients in 1993 indicated that vendors were having difficulty in transferring the high quality of service associated with their data centre management to desktop services.

However executives' ratings of outsourcing vendors' technical capabilities are high compared to the ratings of their commercial abilities. Outsourcing vendors' commercial skill ratings are again similar to those received by in-house IT departments. Approximately half of the executives interviewed perceive their outsourcing vendor to have good business understanding.

Indeed executive perceptions deteriorate further when they focus on those skills most relevant to business reengineering such as:

- Strategic consulting capability
- Ability to identify process improvements.

In both these instances, only 15% of executives perceive their outsourcing vendor to have a high level of capability.

However, despite this depressing picture, there are three areas of encouragement for outsourcing vendors. Firstly outsourcing vendors appear to be perceived to have a slightly higher capability than IT departments in applying technology to business objectives. Secondly outsourcing vendors are perceived to have much higher levels of change management capability than their in-house counterparts.

Finally, cost effectiveness is still a real issue for the in-house IT department. Less than a quarter of the executives interviewed perceived their in-house IT department to have a high level of cost-effectiveness. Indeed a quarter of the executives stated the cost effectiveness of their IT department to be low. This latter situation creates opportunities for outsourcing vendors even if their commercial skills remain underdeveloped.

Executives Unwilling to Involve Vendors in Business Process Definition

Only a small proportion of executives perceive outsourcing vendors to be capable of making a significant contribution towards the identification of process improvements. Accordingly it is not surprising that the majority of executives do not wish their vendors to become involved in the early stages of business reengineering.

Exhibit 3 shows the profile of project stages at which executives believe their vendor should become involved.

Exhibit 3

Stage of Involvement of External Vendor

	Proportion of Mentions (%)		
Stage	France	Germany	U.K.
Business strategy identification	15	30	7
Business process definition	30	17	13
System specification	20	35	40
Development and implementation	35	18	40
Total	100	100	100

Sample of 52 executives. *Source: INPUT*

Overall the majority of executives perceive that vendors should only be involved once the new business process has been defined. This view is especially marked in the United Kingdom. In the U.K., this perspective is part of an overall management culture that:

- Views information technology as a support tool rather than a driving force behind business reengineering.
- Makes a strong distinction between commercial and technical skills.

However executives in Germany and France take a more positive stance towards information technology, and are consequently more likely to expect their outsourcing vendors to become more involved in the early stages of business reengineering initiatives.

Vendors Must Demonstrate Their Impartiality and Speed of Response

Outsourcing vendors need to address a number of issues if they are to take advantage of this demand.

Firstly, as mentioned earlier, vendors need to enhance their commercial abilities by improving their understanding of each client's business and demonstrating their ability to identify process improvements.

Secondly vendors need to address concerns regarding their flexibility. Both outsourcing vendors and IT departments are regarded as excessively tied to corporate IT policies and particular operating environments. In addition, the ability of outsourcing vendors to respond to business reengineering initiatives is seen to be restricted by the length and rigidity of their contracts. In conjunction with this, vendors need to demonstrate their superior capability to assist their clients in the rapid implementation of new technologies. One of the major criticisms of in-house IT departments across Europe is their slow acceptance and adoption of new technologies and systems architectures.

Finally vendors need to demonstrate their breadth of vision and impartiality. Currently, some executives perceive that outsourcing vendors can only view new business initiatives from an IT perspective, and that any suggestions may be driven by self-interest rather than by a desire to act in the client's best interest. Again this criticism parallels a criticism made of in-house IT departments that they need to develop the ability to act for the overall good of the company irrespective of the impact on their department.

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Research Bulletin

A Publication from INPUT's Outsourcing Information Systems Programme – Europe

Vol. V, No. 15 September 1994

Industry Sector Focus Grows in Importance in the Outsourcing Market

At present, outsourcing services are largely provided on a cross-industry basis. Industry focus remains a comparatively minor positioning parameter in the European outsourcing market. However, this situation will change in the future. As outsourcing becomes more influenced by business reengineering and business process management, so industry, process and application specific knowledge will increase in importance. Consequently vendor selection criteria in the outsourcing market will come to more closely resemble those in the systems integration market.

Some vendors are already reorganising their structures to increase the level of industry-specific skills available to their outsourcing business units. For example, Hoskyns has reorganised into four customer facing divisions targeting the finance, public, industry and services sectors.

In the medium-term, outsourcing opportunities are most likely to be generated within the following industry sectors:

- Manufacturing
- Public sector
- Financial services.

The utilities sector in the U.K. has been the source of considerable transition outsourcing activity. However, although this sector may become of increasing importance elsewhere in Europe, the utilities (with the exception of British Gas) have now largely completed their restructuring in the U.K. and so the sector is expected to show lower levels of activity over the next few years.

Manufacturing Sector is the Key Sector in Germany

Exhibit 1 provides a forecast for the European outsourcing market by industry sector. This forecast includes SAP outsourcing and business operations in addition to IS outsourcing.

Exhibit 1

Industry Sector Breakdown, Europe 1994-1999

Sector	Europe 1993 ($M)	Europe 1994 ($M)	Growth '94-'99 (%)	Europe 1999 ($M)
Government	700	1,000	24	3,000
-Local	330	450	29	1,600
-Central	230	400	21	1,100
Manufacturing	1,220	1,600	15	3,200
-Discrete	710	1,000	14	1,900
-Process	510	570	18	1,300
Financial Services	730	900	18	2,100
-Banking & Finance	460	570	20	1,400
-Insurance	270	330	14	650
Distribution	300	360	18	830
Transportation	70	120	23	330
Utilities	265	310	16	670
Other	260	130	22	360
Total Outsourcing	3,500	4,400	19	10,000

Source: INPUT

There is no consistent pattern of outsourcing by industry sector across individual countries. However, the manufacturing sector in Europe has tended to be in the vanguard in the adoption of outsourcing. The manufacturing sector was the major user of IT outsourcing in Germany during 1993. In the U.K., the British Aerospace contract will ensure that the discrete manufacturing sector remains the principal sector for U.K. outsourcing in 1994.

So far, the major manufacturing companies in Italy have not tended to use outsourcing as a means of cost reduction and capital restructuring to the same extent as their counterparts in Germany and the U.K.. However, IBM ISSC has won a number of contracts in the Italian manufacturing sector in 1993 and early 1994 and the level of activity in the Italian manufacturing sector is forecast to increase over the next few years.

Exhibit 2 provides a forecast for Germany broken down by industry sector.

Manufacturing remains, as in 1992, the most important industry sector for outsourcing in Germany. The IS outsourcing contracts of IBM ISSC and EDS are dominated by manufacturing organisations. Many of these organisations are experiencing financial problems, brought about by growing competition from U.S. and Japanese manufacturers, and the recession in their home market.

Exhibit 2

Industry Sector Analysis
Outsourcing Market Germany, 1994-1999

Sector	Germany 1993 (DMM)	Germany 1994 (DMM)	Growth '94-'99 (%)	Germany 1999 (DMM)
Government	50	75	38	370
-Local	20	37	46	250
-Central	30	37	27	120
Manufacturing	455	500	12	900
-Discrete	300	330	10	550
-Process	155	170	15	350
Financial Services	310	390	10	620
-Banking & Finance	165	210	12	370
-Insurance	145	180	6	250
Distribution	50	75	19	175
Transportation	20	35	22	100
Utilities	100	130	15	300
Other	40	20		25
Total Outsourcing	1,030	1,230	15	2,485

Source: INPUT

SAP outsourcing is also important in Germany. Historically, SAP outsourcing was essentially a processing service concerned with providing access to SAP software to small and medium-sized organisations that could not afford to purchase the required mainframe. However, the nature of SAP outsourcing is now beginning to change as the R/3 product begins to replace, or complement, organisations' use of R/2.

This creates both a threat and additional opportunities for vendors. Since medium-sized enterprises no longer require access to an expensive mainframe, they are no longer dependent on the processing firms offering R/2 based services. However, these organisations have traditionally been dependent on external vendors for their IT services and will tend to lack the skills required to support R/3, especially if this is to be implemented using a client/server architecture.

Accordingly, while the SAP processing services vendors may lose some of their traditional client base on their mainframe based services, these same organisations may need extensive assistance in implementing and managing R/3.

In addition, large organisations downsizing from R/2 to R/3 will create a transition outsourcing market where external vendors are required to take over the operation of existing R/2 services. This may also create follow-on opportunities for distributed systems management of the R/3 environment.

Public Sector is the Major Growth Opportunity in the U.K.

The public sector is forecast to exhibit the highest rate of outsourcing growth in Europe over the next five years. At present, public sector outsourcing is particularly evident in the U.K. but is likely to grow in importance elsewhere in Europe over the next five years.

Exhibit 3 provides a forecast for the United Kingdom broken down by industry sector.

During 1993, many outsourcing vendors in the U.K. re-focused their efforts on targeting the public sector. Major opportunities continued to emerge in local government, where organisations such as Data Sciences and ITnet began to assemble business operations capabilities to complement their traditional IT outsourcing offerings. This capability is becoming critical as local authorities respond to the requirements of Compulsory Competitive Tendering and outsource their exchequer functions alongside their IT. Vendors such as ICL/CFM and the Capita Group that are primarily active in the local government sector showed exceptionally high outsourcing growth in 1993 (76% in the case of ICL/CFM), and this high level of growth is expected to continue during 1994 and 1995.

Exhibit 3

Industry Sector Analysis
Outsourcing Market United Kingdom , 1994-1999

	UK 1993 (£M)	UK 1994 (£M)	Growth 94-99 (%)	UK 1999 (£M)
Government	270	395	22	1,100
-Local	130	170	27	560
-Central	70	150	20	370
-Health	70	75	15	150
Manufacturing	240	365	16	770
-Discrete	120	230	15	460
-Process	120	135	18	310
Financial Services	120	140	24	400
-Banking & Finance	85	100	25	305
-Insurance	35	40	20	100
Distribution	45	55	25	170
Transportation	0	10	40	55
Utilities	50	50	10	80
Other	45	5	25	15
Total Outsourcing	770	1,020	20	2,575

Source: INPUT

The first contracts from the U.K. Government's market testing programme emerged towards the end of 1993. Market testing is aimed at improving the efficiency of central government departments. EDS was particularly successful, winning the Inland Revenue contract and successfully bidding for the purchase of DVOIT (the former IT arm of the Driver and Vehicle Licensing Authority). The market testing programme will maintain its momentum during 1994 and 1995.

Compulsory Competitive Tendering and Market Testing will generate significant growth in the UK outsourcing market during 1994 and 1995. However, vendors need to take advantage of this window of opportunity since a change in government may result in these initiatives being cancelled after the next election, due by early 1987 at the latest.

The government sector has so far shown few opportunities for outsourcing vendors in France. However, this is expected to change as the Government evaluates outsourcing IT functions in central government departments and encourages IT outsourcing within local government.

In Germany also, the public sector is now facing strong pressure to increase its efficiency. In particular, there are indications that the regional energy authorities may be privatised. Such a move would lead to a significant increase in their IT expenditures, and would create opportunities for outsourcing vendors.

The public sector in Italy is facing considerable pressure to reduce cost, and, at the same time, is being decentralised to transfer operational service responsibility to the local level. There may be potential for business operations outsourcing in Italy arising out of this major re-organisation of operating responsibility.

Financial Services Sector is Critical in France and Italy

The major European financial institutions have been relatively slow to adopt systems operations. These organisations typically view their IT systems as more business critical than do manufacturing companies. In addition, they will remain heavily dependent on their mainframes for some time.

However, medium-sized financial institutions are a major applications operations opportunity in Germany and Italy.

However, in Italy, many of the banks currently show a preference for taking a shareholding in their outsourcing vendor and limiting the outsourcing vendor's customer base within their sector.

In addition, much of the new activity in the desktop services and application management segments of the market is being generated within the financial services sector.

Financial institutions are amongst the leaders in the adoption of client/server and desktop technologies, and have begun to use external vendors to support their ageing legacy applications.

The financial services sector is a particularly important feature of the outsourcing and processing services markets in France.

Exhibit 4 provides a forecast for the French market analysed by industry sector.

In France, the financial services sector makes considerable use of processing services such as card processing and electronic funds transfer from vendors such as Sligos and Axime, and there is potential for these types of service to develop into business operations contracts involving a wider range of billing and revenue collection activities.

Exhibit 4

Industry Sector Analysis
Outsourcing Market France, 1994-1999

	France 1993 (FFM)	France 1994 (FFM)	Growth 94-99 (%)	France 1999 (FFM)
Government	425	560	23	1,550
-Local	190	280	25	850
-Central	235	280	20	700
Manufacturing	1,500	1,800	15	3,600
-Discrete	940	1,120	14	2,150
-Process	560	670	17	1,450
Financial Services	990	1,290	18	2,900
-Banking & Finance	660	840	18	1,920
-Insurance	330	450	17	980
Distribution	700	780	12	1380
Transportation	235	280	15	560
Utilities	330	390	22	1,100
Other	560	500	20	1,250
Total Outsourcing	4,700	5,595	17	12,300

Source: INPUT

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October 1994

The Need for New Systems Causes CFOs To Investigate IT Outsourcing

Organisations that have adopted outsourcing typically show a high need to reduce their level of IT expenditure. However, financial considerations alone do not appear to be the main triggers that cause organisations to seriously consider use of IS outsourcing.

An earlier research bulletin (Information Systems Outsourcing Programme, Vol. V, No. 13) showed that organisations that have adopted IS outsourcing are at least as enthusiastic about applying IT to their business as organisations that have retained an in-house IT department.

On average, it appears that:

- Chief Financial Officers (CFOs) are the most influential figures in initiating use of outsourcing, but their motivations extend beyond the desire to cut costs
- Outsourcing is typically triggered by a need for new systems
- The injection of new skills is paramount.

CFO Is Most Influential In Initiating Use Of Outsourcing

Exhibit 1 lists the perceived importance of the parties shown in promoting the use or evaluation of IS outsourcing.

Both IT managers and CFOs perceived themselves to be the most important instigator of outsourcing within their organisation.

However, overall the CFO emerged as the most important person in this role. IT managers recognised the importance of the CFO in over 50% of instances. Non-financial senior executives perceived the CFO to be more important than the chief executive officer (CEO), and appreciably more important than the IT director or manager, in initiating outsourcing.

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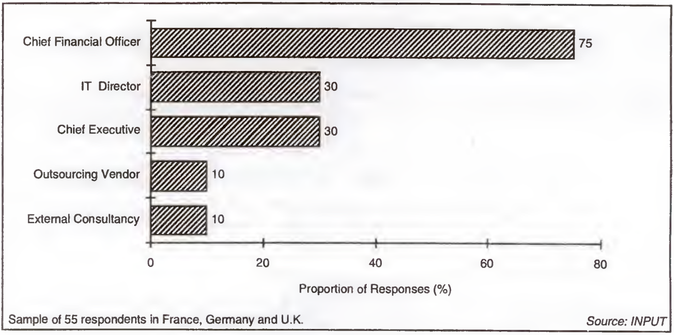
Exhibit 1

Principal Initiators of Outsourcing



Sample of 55 respondents in France, Germany and U.K.

Source: INPUT

The overall influence of external consultancies and outsourcing vendors in initiating outsourcing is perceived to be low. However, consultancies were occasionally a major influence when asked to investigate the relevance of IT outsourcing to an organisation and making a positive recommendation. Consultancies are more typically used to assist organisations in deciding the pattern of functions to be outsourced and the choice of vendor, once the decision to adopt outsourcing has been made.

Outsourcing Typically Triggered By Need For New Systems

Exhibit 2 lists the principal circumstances that have led organisations to the decision to evaluate outsourcing.

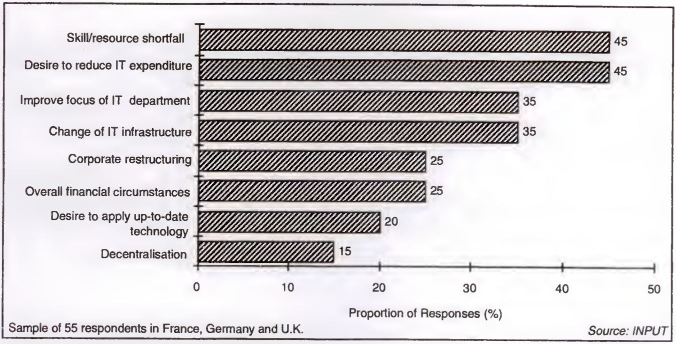
As expected, the desire to reduce, or stabilise, IT expenditures is one of the major factors. This is particularly the case where the overall organisation is having financial difficulties (for example British Aerospace) and needs to reduce expenditure wherever possible. In these circumstances, outsourcing computer data centres can produce both short-term cost savings and an immediate cash injection.

However, other equally important motivations for outsourcing are changes in IT infrastructure and the pressures this creates for the in-house IT department. One of these pressures is the increased workload necessary to support existing systems while simultaneously handling major new systems development projects. Outsourcing has traditionally been a way of offloading the operation of and support for existing systems, enabling the in-house IT department to concentrate its efforts on new systems development.

Outsourcing is also a means by which the organisation can acquire the necessary specialist expertise and skills in the new technologies being adopted.

Exhibit 2

Circumstances for Outsourcing



Sample of 55 respondents in France, Germany and U.K.

Source: INPUT

Perhaps surprisingly, cost reduction is not the most highly-rated reason for outsourcing given by CFOs. Exhibit 3 provides a breakdown of reasons for outsourcing by respondent type.

The personnel for whom reducing the organisation's overall IT expenditure is the single most important reason for evaluating outsourcing are non-financial senior executives, including the Chief Executive Officer (CEO). For CFOs and IT managers, the most important reason for considering outsourcing is a shortfall in IT skills. For all senior executives, including CFOs, a change in IT infrastructure is a major factor in their decision to evaluate outsourcing. Against this background, the majority of respondents considered that the decision to evaluate outsourcing was prompted by a specific event. The major events identified by respondents are listed in Exhibit 4.

Exhibit 3

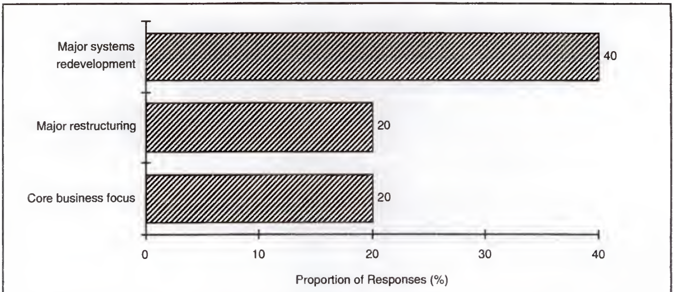
Reasons For Outsourcing By Respondent Type

Reason for evaluating outsourcing	CFO	IT Directors/ Managers	Senior Executives
Skill/resource shortfall	60	50	30
Desire to reduce IT expenditure	40	40	50
Improve focus of IT department	25	45	40
Change of IT infrastructure	50	25	45

Source: INPUT

Exhibit 4

Triggers For Outsourcing



Sample of 55 respondents.

Source: INPUT

The single most important factor that triggered the need to evaluate outsourcing was a major systems redevelopment project. This causes many organisations to recognise that they lack the resources or expertise to handle the resulting increase in activity.

Company relocation and restructuring were also important in initiating evaluation of outsourcing, as was a change in senior company management or a change in company ownership.

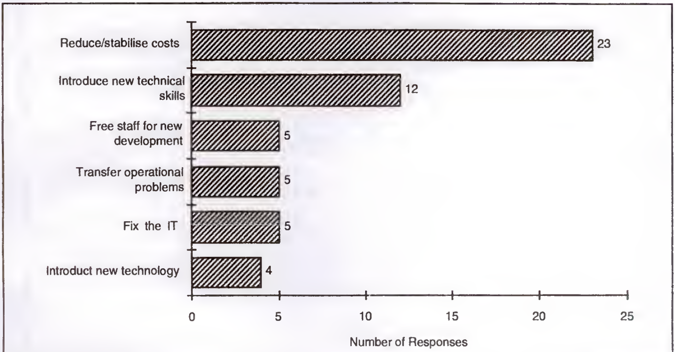
Other factors mentioned include a loss of confidence in the internal IS department and a review of internal business processes.

The Injection Of New Skills Is Paramount

Exhibit 5 lists the major roles that IT outsourcing was expected to play.
The primary role of IT outsourcing is seen as reducing or stabilising IT costs. However, the second most important role of IS outsourcing is to facilitate the introduction of new technology by providing up-to-date knowledge and technical expertise that is lacking within the client's organisation. Many managers remain concerned that their organisations are reacting too slowly to the challenge of introducing new technology. Outsourcing is also viewed as a means of reducing the risks resulting from the scarcity of staff with up-to-date skills. Outsourcing is seen as a way of introducing new management talent and as a means of reducing the company's exposure to the departure of key IS personnel.

Exhibit 5

Role Of IT Outsourcing



Sample of 55 respondents.

Source: INPUT

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IT 2000
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Research Bulletin
A Publication from INPUT's Outsourcing Information Systems Programme – Europe
Vol. V, No. 18 October 1994

IT Directors Favour Vendors Offering Flexible Outsourcing Contracts

IT directors and managers are significantly less likely than chief financial officers to initiate IS outsourcing within their organisations. However, once the decision to adopt IS outsourcing has been taken, then IT directors become very closely involved in the selection and management of the outsourcing vendor. Accordingly selection criteria favoured by IT directors are important attributes that must be respected by the outsourcing vendor community.

In formulating their sales strategies, vendors should recognise that:

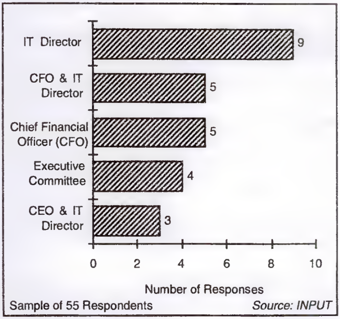
- IT directors are the key parties in vendor selection
- The flexibility of the vendor in adapting its offerings to the client's requirements is extremely important in the final stages of vendor selection

IT Directors are the Key Parties in Vendor Selection

Exhibit 1 lists the key parties involved in vendor selection.

Exhibit 1

Key Parties in Vendor Selection



Sample of 55 Respondents *Source: INPUT*

The IT director is typically the individual with the highest influence during the vendor selection process. Overall, the IT director was judged to be a key influencer in vendor selection in 75% of instances, compared to 40% of instances for Chief Financial Officers, and 30% for Chief Executive Officers.

While IT directors frequently work alongside other directors during the vendor selection process, they were regarded as being solely in charge of vendor assessment in 30% of instances, a proportion approximately double that of Chief Financial Officers.

A study conducted by INPUT in the US. similarly concluded that the in-house IS department dominates the management of the evaluation and selection process, either through direct management of the process or leadership in many of the phases.

In particular, the IS department was identified as the leader in the following stages of the evaluation process:

- Capabilities analysis
- RFP preparation
- Selection of shortlist
- Management of bidders' conference
- Development of selection criteria
- Vendor communications
- Recommendations

On the other hand, the finance department was identified as the key area for:

- Developing financial models
- Cost analysis of proposals

Overall, the finance department plays the secondary role in the actual management of vendor selection, but has a relatively high degree of influence on the outcome by:

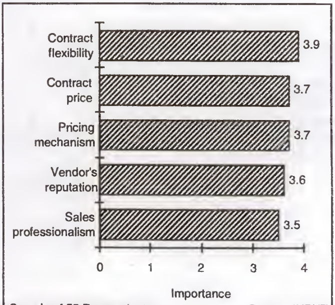
- Setting the basis for the comparison of proposals through its heavy involvement in the cost analysis activity
- Controlling the algorithmic parameters that are used to compare the financial aspects of vendor proposals through direct involvement in the development of models
- Acting as the final authority on the validity of the financial projections coming out of the process

Contract Flexibility is Important in Final Stages of Vendor Selection

Exhibit 2 lists the perceived importance of each of a number of factors in influencing the final choice of vendor.

Exhibit 2

Criteria Influencing Final Choice of Vendor



Sample of 55 Respondents

Source: INPUT

Contract flexibility was perceived to be the most important factor. Indeed, there are signs of a reaction in the user community against contracts that are viewed as too long or based on too rigid a framework. For example, the Royal Borough of Windsor and Maidenhead switched vendors, even after the organisation had nominated its preferred vendor, in order to reduce the contract length from five years to a more flexible three-year arrangement.

Similarly, CFM won a contract with CWS because CFM was prepared to take a property lease the length of which significantly exceeded the length of the initial IS outsourcing contract.

The vendor's reputation is an important criterion for Chief Financial Officers and other senior executives. However, IT directors tend to be less concerned with the vendor's reputation and are more influenced by their current working relationships with vendors.

Contract price is not as important to Chief Financial Officers as contract flexibility, but remains very important to IT directors and chief executive officers. IT directors still often view cost savings as the key rationale for outsourcing; as an alternative to in-house services.

Cultural compatibility received a surprisingly low rating. This may be because cultural compatibility is best demonstrated by the vendor's existing relationship with the client and the flexibility displayed in meeting the needs of the client within the outsourcing proposal and contract.

Certainly a lack of flexibility has been a major factor in unsuccessful bids. Reasons cited by executives for eliminating vendors from the bidding process included:

- Contract terms too long
- Potential difficulties in terminating the contract
- Incompatibility between vendor and client
- Contract inflexibility
- Vendor desire to provide more comprehensive service than required by client

This need for flexibility applies not only at the initial contract negotiation stage, but also during the life of the contract. For example, Heinz has recently re-negotiated in mid-contract the terms of its outsourcing contract with Hoskyns.

A breakdown of the relative importance of selection criteria by party is shown in Exhibit 3.

Exhibit 3

Selection Criteria by Respondent Type

Importance	IT Directors/Managers	Chief Financial Officers	Other Senior Executives
High	Contract flexibility Contract price Pricing mechanism		Contract flexibility Contract price Vendor's reputation Pricing mechanism
Medium–High	Existing relationship Sales professionalism	Sales professionalism Contract flexibility Vendor's reputation	Cultural compatibility

Source: INPUT

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Vol. V, No. 20

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Vendors Position Themselves in Readiness for Compulsory Competitive Tendering

The UK Government is enthusiastic about increasing the role of the private sector in the provision of public services within local government. This has created an IT outsourcing market in local government worth approximately $75m in 1993. However, in the second half of 1994, there has so far been a reduction in the level of activity within the UK local government outsourcing market.

This reduction is seen as a temporary pause as local authorities address the implications of local government reorganisation. Indeed the complete market testing programme within local authorities has been delayed as these organisations undertake the consultation process and manoeuvrings to establish future local government boundaries.

In trying to remove one layer of local government, central government has inadvertently provided local government with the ideal excuse to delay other reforms, including market testing. Some local authorities may try to delay the introduction of market testing beyond the deadlines, in the hope that a change of government will produce a reversal in policy toward market testing.

Despite this recent pause in the flow of local government outsourcing contracts, there has been considerable vendor activity during 1994 as:

- The established outsourcing vendors in this sector endeavour to maintain their market shares
- Capita continues to enhance its position in the managed services, or business operations, segment
- Recent entrants to the IS outsourcing market endeavour to position themselves in the local government sector in readiness for the arrival of Compulsory Competitive Tendering (CCT)

CFM Maintains 50% Share of Local Government IT Outsourcing

Exhibit 1 lists the IT outsourcing contracts that have been signed in the UK local government sector during 1994.

Exhibit 1

IT Outsourcing Contracts UK Local Government, 1994

Client	Vendor	Contract Value ($m)
Greenwich LBC	CFM	36
Bolton MBC	CFM	31
Croydon LBC	ITnet	27
Bexley LBC	ACT Managed Services	19
Brighton BC	Athesa/Data Sciences	7
Cambridge City Council	CMS	6
City of Rochester	MDIS	5
Royal Borough of Windsor and Maidenhead	PCL	4
Ealing LBC	Data Sciences	0.6
Brent	Data Sciences	0.1
	Total contracted value	135

Source: INPUT

CFM is currently the market leader in local government IT outsourcing with an installed base of approximately 30 local government clients and 1993 revenues of approximately $60m.

The other vendors that have traditionally targeted local government outsourcing are:

- Telecom Capita (now Capita Managed Services)
- ITnet
- Data Sciences
- ACT Managed Services (formerly BIS Perthcrest)
- MDIS

Each of these vendors is endeavouring to strengthen its market position, and at least maintain its market share, prior to the arrival of Compulsory Competitive Tendering (CCT).

However, an orderly outsourcing market favours these established vendors. One of the principal fears of vendors such as CFM is a loss of market share resulting from large numbers of local authorities being forced to market test their IT services simultaneously. A more gradual introduction of market testing would be to CFM's advantage.

So far in 1994, CFM has been successful in maintaining a 50% market share of new contracts by value, winning the two largest IT outsourcing contracts to emerge from local government.

ITnet has also managed a major boost to its local government outsourcing revenues with a major win.

Data Sciences, on the other hand, has had a relatively unsuccessful year, despite winning Brighton Borough Council in partnership with Athesa. One factor leading to this lack of success is the company's unwillingness to establish additional data centres; still a key factor in the local government market.

CFM, for example, is still developing its IT outsourcing infrastructure and is prepared to continue to acquire data centres in support of its activities.

Capita Continues to Progress in Managed Services

One company noticeable by its absence in Exhibit 1 is Capita. Capita has traditionally been one of the market leaders in local government IT outsourcing, and remains second to CFM in this market.

However, the company was also one of the first to target business operations outsourcing or managed services in local government.

Capita is the most successful of the IT outsourcing vendors in targeting managed services, and has established itself as the market leader in local tax collection services.

In 1994, the two contracts shown in Exhibit 2 commenced.

Exhibit 2

Managed Services Contracts UK Local Government, 1994

Client	Vendor
London Borough of Bexley	Capita Managed Services
London Borough of Westminster	Capita Managed Services

Source: INPUT

These are worth a combined total of $21m. The company already had managed services contracts with:

- East Cambridgeshire District Council, for revenue collection
- London Borough of Bromley, covering outsourcing of the entire exchequer services function namely revenues, benefits, payroll, pensions, creditors and income. This contract involved the transfer of 170 personnel to Capita Managed Services
- Mendip District Council, where Capita Managed Services manages the exchequer functions, in addition to providing IT outsourcing services

While other vendors, such as ITnet, have begun to offer managed services, Capita has established a significant lead in this market relative to other IT outsourcing vendors.

Exhibit 3 shows the timetable for financial services CCT in local government.

Exhibit 3

Timetable for Financial Services' CCT UK Local Government, 1994

Organisation Category	Date
London & metropolitan boroughs	September 1996
Unitary Councils established in 1995	September 1997
Unitary Councils established in 1996	September 1998
Councils reviewed but not reorganised	September 1998
Unitary Councils established in 1997	March 1999

Source: CIPFA

This suggests that in approximately one year's time, there will be a large number of councils beginning to tender their financial services' provision.

Those vendors that have a well-established client base before then will have a significant market advantage, though again, it may be difficult for a small number of vendors to handle all the requests for proposals arising at this time.

Even with the phasing now being introduced as a result of local government reorganisation, there will still potentially be approximately 100 authorities per annum tendering elements of their financial services, over the next few years. The main threat to this programme remains a change in government. However, even under these circumstances, a significant proportion of London and metropolitan boroughs can be expected to put financial services out to tender.

New Entrants Target Local Government

Local government is a frequent target for new entrants to the UK IT outsourcing market because of the high level of activity, both present and future.

In 1994, both Athesa and CMS began their first local government outsourcing contracts. Athesa, Groupe Bull's outsourcing subsidiary, was determined to establish itself in local government outsourcing, given Bull's high level of local government experience. To ensure this foothold in local government, Athesa put in a significantly lower bid than CFM to win the Brighton contract.

In addition, PCL won its first sizeable local government contract, taking advantage of the Royal Borough of Windsor and Maidenhead's sudden desire to reduce the contract length from five years to three years after it had nominated ITnet as its preferred supplier on the basis of a five year contract.

Because of the attractiveness of the local government sector to new entrants, it is generally possible for authorities to find a vendor that will both retain their existing data centre and personnel, and also offer them a competitive price.

All of the contracts awarded so far are deemed to be the result of Voluntary Competitive Tendering (VCT) since Compulsory Competitive Tendering has yet to come into operation.

There are two distinct motivations for Voluntary Competitive Tendering. One is a belief in the concept of the *enabling authority.* An *enabling authority* is a local authority that is responsible for the delivery of services to the public, but does not undertake service delivery itself. The motivation driving the majority of the contracts listed above is a belief in the merits of the enabling authority concept, and such authorities will tend to be early adopters of IS outsourcing.

The other motivation is a belief that Compulsory Competitive Tendering (CCT) will be imposed in the near future and cannot be avoided. Within this scenario, a number of authorities have decided to try to protect the interests of their existing staff by being in the vanguard of the movement to IS outsourcing.

So far, local government IT staff transferred to outsourcing vendors have tended to be regarded as highly valued personnel, used as the nucleus of the vendor's service. This has been particularly true given the number of vendors enthusiastically endeavouring to establish regional data centres with local government expertise prior to CCT. However, once CCT gets firmly established, vendors will be less prepared to acquire additional data centres and large numbers of local government IT personnel are likely to be made redundant.

Accordingly, a number of local authorities have decided to be early adopters of IT outsourcing to ensure that their data centres and personnel become indispensable to the outsourcing vendor.

Such action has been particularly prevalent within county councils. IT personnel within county councils are most at threat, both as a result of the impending local government reorganisation, and their historic concentration on mainframe-based services.

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Research Bulletin

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Vol. V, No. 19

October 1994

Business Process Expertise will be the Key to Success by Year 2000

Outsourcing is still viewed by many users and some vendors as a short-term phenomenon, primarily concerned with reducing the cost of data centre management. From this viewpoint, it can be argued that outsourcing is close to reaching its saturation point, and will begin to decline as the major economies recover and as organisations learn how to increase the productivity of their data centres.

However, there is an alternative scenario in which data centre outsourcing is only the first tentative step in the development of outsourcing. Within this scenario:

- Outsourcing growth will remain strong into the next century
- Technical complexity will lead to outsourcing of client/server infrastructures
- Vendors will need to develop a depth of business process expertise to address the reengineering of core processes
- Outsourcing of non-core processes will generate business operations contracts

Outsourcing Growth To Remain Strong Into The Next Century

Exhibit 1 shows INPUT's forecast of overall IT- related expenditure over the next five years.

The overall growth in IT expenditure in Europe over the next five years is expected to be minimal and almost certainly less than the rate of inflation. The principal trend will be the switch from internal spending to increased expenditure on external services and software products. IS outsourcing is expected to be a particularly strong beneficiary of this switch in the spending profile.

Within this scenario, IS outsourcing can grow at an average rate of 19% per annum and still only increase its share of overall IT expenditure from 2% to 3%. Hence, market saturation is unlikely to act as a constraint on outsourcing growth during this century. Indeed, IS outsourcing could grow at 28% per annum over the next five years, and still only account for 5% of IT expenditure by 1999.

Exhibit 1

IT Expenditure: 1994-1999

	Europe ($m) 1994	Proportion (%)	Europe ($m) 1999	Proportion (%)	CAGR (%)
Equipment related	83200	33	88100	32	1
In-house	97000	39	84000	31	-3
Other external services	43100	17	59700	22	7
IS Outsourcing	3900	2	9300	3	19
Software Products	22300	9	31600	12	7
Total	**249500**	**100**	**272700**	**100**	**2**

Source: INPUT

In particular, there is considerable scope for growth in outsourcing by organisations. Exhibit 2 summarises how the driving forces for outsourcing are expected to develop over the next five years.

At present, the major driving forces for IS outsourcing are the transition between centralised and decentralised IT architectures coupled to a perceived need to reduce IT expenditure. However, while there will still be organisations undergoing this change in architecture in five years time, the principal reasons for outsourcing will have evolved. By 1999, the major needs of organisations will be the need to manage this new, decentralised client/server architecture, the need to apply information technology in support of reengineering core business process and the need to manage non-core business processes in their entirety.

Exhibit 3 indicates the impact of these changes on the outsourcing market. It divides the outsourcing market into three segments:

- Data centre management and application maintenance management
- Client/server management, desktop services and application development management
- Business process management

Exhibit 2

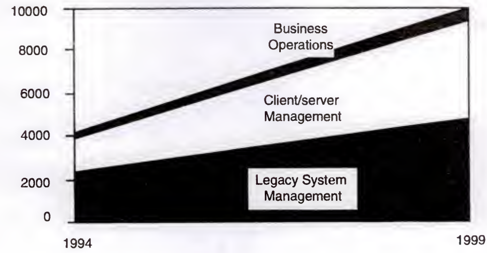
Motivations for Outsourcing

Motivations for Outsourcing	1994	1999
Managing transition between architectures	*****	**
Cost reduction/capital injection	****	**
Technical complexity	**	****
Re-application of IT to business	*	*****
Outsourcing of non-core processes	*	*****

Source: INPUT

Exhibit 3

Outsourcing Service Development Revenues by Service Type: 1994-1999



Source: INPUT

In this diagram, business operations outsourcing and client/server management are forecast to grow at approximately double the rate of legacy system management (27% per annum compared to 14% per annum over the next five years). However, even with this large growth differential, legacy system management will remain the dominant component of outsourcing revenues, if not new business, until the year 2000.

Indeed, if business operations outsourcing is to account for just 10% of European outsourcing revenues by 1999, then this activity will need to average 38% per annum growth over the next five years.

This level of growth in business process outsourcing could easily be achieved, or exceeded, if the concept of business reengineering becomes widely adopted and organisations outsource business processes that are either non-core or not performed to a world-class standard in-house. The ultimate market potential for business operations outsourcing is many times that of IS outsourcing.

Technical Complexity Will Lead to Outsourcing of Client/Server Infrastructures

Exhibit 4 lists the stages through which organisations are likely to pass in outsourcing components of their IT infrastructure.

Organisations will proceed at different paces through this process. Some will move rapidly to stage 4 or 5, others will be content to remain at stages 1 or 2. However, by 1999, it is probable that most organisations will be addressing the challenge of managing client/server architectures rather than data centres.

Vendors Will Need to Develop Depth of Business Process Expertise

Exhibit 5 shows the stages through which organisations are likely to pass in outsourcing components of their systems integration activity and application support. Assuming that many organisations begin to adopt the concept of the virtual corporation, then these organisations' business processes will become separated into core processes and non-core processes. Core processes will need to be reengineered intermittently. At this point, organisations will need the assistance of a partner with considerable expertise, and preferably the ability to introduce world-class practice, in the relevant business process.

Exhibit 4

Stages in IT Infrastructure Management

Stage	Action
Stage 1	Controls, manages and operates infrastructure
Stage 2	Outsources data centre management
Stage 3	Seeks help in implementing client/server infrastructure
Stage 4	Outsources client/server operation and management Retains end user first-line support
Stage 5	All IT infrastructure financed and supported by vendors Monitors architecture strategy and vendor performance

Source: INPUT

Exhibit 5

Stages in IT Application Support

Stage	Action
Stage 1	Builds and maintains all applications centrally
Stage 2	Decentralises user support to divisions/business units Extensive use of application software products
Stage 3	Outsources application maintenance Subcontracts development and implementation
Stage 4	Seeks help in reengineering individual business processes Outsources non-core business processes
Stage 5	Reverts to central team with O&M/reengineering skills

Source: INPUT

This business process expertise could be developed across a range of industries, enabling best practice to be transferred between industry sectors. In this scenario, vendors should develop a number of business process, rather than industry competence centres. Already some vendors are finding that a high level of industry-specific knowledge can be a disadvantage in addressing business reengineering projects, since established custom and practice inhibits the adoption of innovative approaches to the business problem.

Outsourcing of Non-Core Processes Will Generate Business Operations Contracts

Organisations are expected to retain a high level of control over the reengineering of their core business processes. However, they will ultimately be seeking to outsource a wide range of non-core business processes.

Those business processes identified as non-core can be expected to vary considerably, even between organisations apparently in the same industry sector, according to the individual organisation's strategy and perceived strengths and weaknesses. However, areas such as accounting, order processing, client liaison and logistics are major outsourcing opportunities.

Exhibit 6 attempts to summarise the major opportunities for vendors that arise at each stage within this model.

The corresponding changes in skill profile required by outsourcing vendors to take advantage of these opportunities are listed in Exhibit 7.

Exhibit 6

Opportunities for Vendors

Stage	Opportunity
Stage 1	Bodyshopping Systems software
Stage 2	Data centre management Application software products
Stage 3	Application maintenance management Systems integration
Stage 4	Client/server management and desktop services Business reengineering Business process management
Stage 5	Ownership of total IT infrastructure Business process management

Source: INPUT

Exhibit 7

Vendor Skill Requirements

Skill	1994	1999
Technical capability	High	Medium
Ability to identify process improvements	Medium	High
Business process management	Low	Medium-High

Source: INPUT

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Research Bulletin

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SAP Outsourcing in Germany – The Focus Switches to R/3

SAP outsourcing is a major business activity in Germany with annual revenues of approximately DM500m. This opportunity has traditionally been based around providing access to SAP software for medium-sized organisations that could not afford the considerable costs associated with running the R/2 product in-house.

However, the introduction of R/3 will have a major impact on the nature of SAP outsourcing in Germany.

One of the opportunities that is now beginning to emerge is the creation of a market for R/3 outsourcing. Much of this market might be expected to arise out of organisations making the transition from R/2 to R/3. However, only a very small minority of R/2 users have so far begun this transition.

At present:

- The initial R/3 outsourcing contracts are primarily emerging from outside the SAP R/2 customer base
- The timing of R/2 transition outsourcing is being strongly influenced by SAP
- A number of vendors each have a small number of R/3 outsourcing contracts but there is no clear market leader for R/3 outsourcing.

Initial Contracts Emerge from Outside the SAP R/2 Base

Exhibit 1 provides a breakdown of current R/3 outsourcing contracts in Germany, by type of service used prior to adoption of R/3 outsourcing.

Exhibit 1

Source of R/3 Outsourcing Contracts

	R/2 User	Other Software Product or In-house Development
External service provider	6	4
In-house service	0	13
Total	6	17

Source: INPUT

At present, approximately three-quarters of the organisations that have adopted R/3 outsourcing did not previously use SAP R/2. These organisations are migrating to R/3 from either a custom development, or from another business software product typically run in-house.

In some cases, vendors are actively encouraging this migration. For example, Hewlett-Packard, who are one of the market leaders in managing SAP R/3 implementation projects in Germany, have been actively encouraging clients of their proprietary applications to convert to R/3, and to use their selective outsourcing services in support of managing the new IT infrastructure.

Organisations that already used an external vendor to provide R/2 based services were another significant source of R/3 outsourcing contracts in 1994. These organisations can be divided into two categories: those purchasing a service from an R/2 bureau and those with a systems operations contract with an outsourcing vendor.

The launch of SAP R/3 introduced a potential threat to the SAP outsourcing vendors. The medium-sized organisations that formed their client base could now purchase a combination of equipment and software more appropriate to their needs, and run it in-house. So far, this threat has not materialised.

In part, this threat has failed to materialise because of the migration costs involved at the present time. However, it is also difficult for such organisations to acquire the necessary skills to design and implement SAP R/3 and a related client/server infrastructure.

Accordingly, few organisations that have traditionally used an R/2 processing service are currently migrating to R/3, and those that are, show a high propensity to continue to use an external vendor to operate their R/3 related infrastructure.

However during 1994, the majority of organisations migrating from R/2 to R/3 were organisations with existing systems operations contracts with outsourcing vendors, such as EDS and IBM Systeme und Netze. It is unclear whether or not these contracts were initially established as transition management contracts with a view to migrating between R/2 and R/3. However, it appears that in many cases the opportunity to introduce R/3 outsourcing arose sometime after the initial systems operations contract had been signed.

For example, many of IBM Systeme und Netze's clients currently use R/2. At the present time, the majority of these clients are not planning imminent moves to R/3, but all of them are likely to be potential R/3 outsourcing clients in the future, as reengineering of their businesses takes place.

Timing of R/2 Transition Outsourcing Strongly Influenced by SAP

Overall, only a very small minority of SAP's R/2 clients have so far replaced their R/2 systems with R/3. The use of R/3 appears to be largely complementary to R/2 at this stage.

Indeed, there are still a number of major obstacles facing organisations endeavouring to migrate from R/2 to R/3 including:

- Migration tools will not be available from SAP until the second half of 1995
- These migration tools will only be available for versions 5.0 and later of R/2. At present, the majority of SAP R/2 users are on earlier versions
- The use of version 5.0 in a production environment requires an increase in mainframe resources of approximately 20% over those required to run versions 4.3 to 4.5
- Most organisations using R/2 have added enhancements to the standard product

- SAP is continuing to enhance R/2 and will introduce version 6.0 towards the end of 1995.

To counter these difficulties for organisations undertaking transitions, SAP is offering a reduction of 50% in licence fees to organisations migrating from R/2 version 4.3 to R/3, and a 70% reduction for organisations migrating from version 5.0.

In addition, some vendors are lessening the impact of the need to upgrade to R/2 version 5.0 by undertaking this upgrade only as an intermediate stage in migration, hence avoiding the expense of upgrading the equipment to enable version 5.0 to run in a production environment.

However, potentially the greatest hurdle to making the transition is the high level of customisation of typical R/2 systems. This can be minimised if users can combine the migration to R/3 with a reengineering, and accompanying simplification, of their business processes to fit one of the business models available within R/3. If this can be done, then it may be possible to avoid the necessity for extensive custom development around the R/3 implementation.

In addition, SAP R/3 will often co-exist with R/2 for a number of years. In many cases, specific modules of R/3 are being implemented alongside R/2 systems. For example, several vendors reported R/3 outsourcing contracts covering just the human resources module.

In other cases, R/3 is being implemented within the smaller subsidiaries of an organisation, with R/2 remaining the principal business solution for the parent organisation for many years.

There are potentially three types of outsourcing opportunity arising from changes in the SAP customer base, namely:

- R/2 transition outsourcing
- R/2 transition outsourcing combined with R/3 outsourcing
- R/3 outsourcing either on its own or in combination with transition outsourcing of non-SAP legacy systems.

R/2 transition outsourcing occurs where an organisation is migrating from R/2 to R/3 and requires an external vendor to phase out its use of R/2, while the organisation itself takes on the R/3 based service provision. These are likely to be short-lived contracts of around two years duration. So far, this type of contract has not emerged, due to the difficulty and expense of migrating between R/2 and R/3. However, this type of outsourcing will grow in importance in the latter part of 1995 and 1996–as some organisations begin to phase out their use of R/2.

It is estimated that up to thirty per cent of the organisations phasing out R/2 in each year will require assistance in the form of transition outsourcing services.

It is estimated that approximately 10% of new users of R/3 will require to outsource the management of their client/server IT infrastructure. In addition, a significant proportion of these organisations will require transition outsourcing from a non-SAP legacy environment.

At present, the SAP R/3 outsourcing market is dominated by organisations migrating from packages other than R/2 and this situation will probably continue during 1995. Thereafter, organisations migrating from R/2 are likely to form the larger element of the R/3 outsourcing market.

No Clear Market Leader for R/3 Outsourcing

Exhibit 2 lists the number of R/3 outsourcing contracts held by the leading vendors offering R/3 outsourcing services at mid-November 1994.

Exhibit 2

Vendor Penetration of R/3 Outsourcing Market

Vendor	Number of R/3 Outsourcing Contracts
EDS	5
tds	4
debis	4
DVO	3
Orga	3
Hewlett-Packard	2
IBM Systeme und Netze	2
Digital	1
Total	24

Source: INPUT

The R/3 outsourcing market is still at a very early stage of development and, at present, no vendor is estimated to have more than five R/3 outsourcing contracts.

The R/3 outsourcing market will be very competitive over the next year with all of the vendors listed above strongly targeting R/3 outsourcing. In addition, other vendors will cnter the market. For example, SNI has a strong position in the SAP project services market and is expected to announce its first R/3 outsourcing contracts shortly.

The keys to obtaining R/3 outsourcing business are likely to be:

- Ability to win projects to implement R/3 and the associated IT infrastructure (i.e. client/server environment)
- Ability to remotely manage and run a client/server based architecture
- Ability to phase out non-SAP based legacy systems
- Ability to win R/2 transition outsourcing contracts.

Some vendors will concentrate on targeting SAP outsourcing via transition management and the run-down of mainframe data centres. Others will concentrate on follow-on business from the successful implementation of R/3 systems.

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Research Bulletin

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December 1994

European Wide Area Networks Fail to Meet Changing Business Needs

Much of the recent activity in the European outsourcing market has concerned vendors developing desktop services outsourcing capability. These services have been developed to address the difficulties organisations are likely to face in managing new technologies in the form of distributed local area networks (LANs). However, changing technology and increasing intra-company communications will place considerable pressure on organisations' wide area networks and have a major impact on the ability of organisations to manage their wide area networks (WANs).

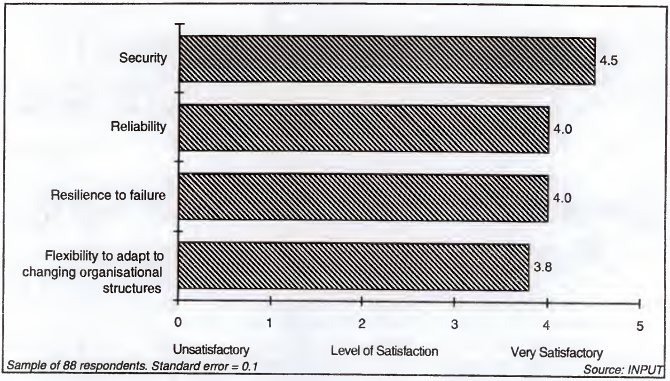
In many ways, the forefront of technological change is now moving from the desktop to the wide area network. Many wide area networks will have to undergo fundamental changes over the next few years if they are to continue to play an effective part in their organisation's use of information technology. At present, many are ill-equipped to facilitate the use of the technology now being implemented at the desktop. As a result, wide area networks are potentially more of an impediment to the application of technology for business advantage over the next few years than are existing datacentres. In particular, many corporate data networks will need to change:

- To provide adequate support for the client/server infrastructures currently being considered or implemented
- To support the use of multimedia on a person to person basis.

The scale of change required, combined with a low level of satisfaction with the current WANs installed, is expected to create a major opportunity for vendors offering wide area network outsourcing services in Europe over the next three years.

Exhibit 1

Most Satisfactory WAN Characteristics



Sample of 88 respondents. Standard error = 0.1

Source: INPUT

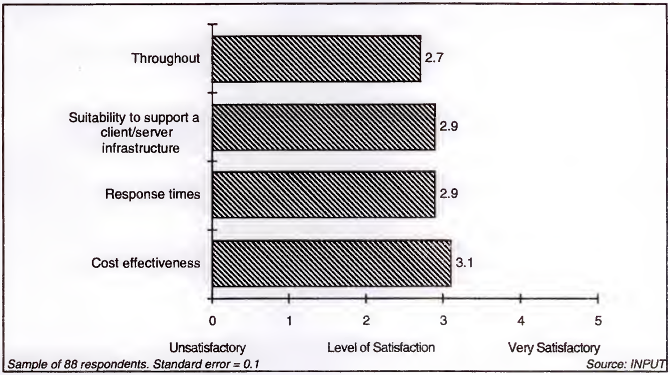
Improved Support for Client/Server Architecture is Required

Exhibit 1 lists those characteristics of existing WANs with which senior executives and IT managers were most satisfied. The need for desktop outsourcing is often being driven by concerns regarding the reliability of in-house supported LANs to achieve the necessary levels of reliability. However, both IT managers and senior executives are broadly satisfied with the ability of their current WANs to provide the resilience and security appropriate to their future business needs. In addition, changing organisational structures caused by corporate restructuring are not perceived to be likely to have a significant impact on the nature of the wide area network.

The characteristics of the current WAN which are perceived to be least satisfactory to support changing business needs are listed in Exhibit 2.

Exhibit 2

Least Satisfactory WAN Characteristics



Sample of 88 respondents. Standard error = 0.1

Source: INPUT

One of the principal challenges facing organisations is increasingly the connectivity and access to applications/data sources of individual users. The following were typical of the challenges mentioned by respondents:

- Implementing client/server in a company-wide sense. Accessing data servers from anywhere in the company
- Further extension of our networking. Remote access from mobile users
- The company needs global communications
- Linking more of our LANs together
- Making more services available to more/all users
- Bringing all locations into the WAN structure
- Integrating the systems of the increasing number of small LAN-based workgroups
- Full user access to all systems, irrespective of location.

Many organisations now expect their future IT architecture to be based around a large number of departmental/workgroup LANs that will need to be fully linked via wide area networks. Existing corporate data networks are commonly perceived to be inadequate to support this style of operation.

Support for Multi-Media on a Person to Person Basis

Exhibit 3 shows the difference between the future importance, and the current satisfaction, of respondents with the ability of their WAN to support a number of potential requirements.

Exhibit 3

Ability of Present WAN to Meet Future Needs

WAN Characteristic	Importance Rating	Satisfaction Rating	Difference
Data transmission	4.9	3.9	1.0
Company's national activities	4.8	3.6	1.2
Cost effective	4.5	3.0	1.5
Inter-LAN connections	4.2	2.9	1.3
Client/server architecture	4.1	2.7	1.4
E-mail	4.1	3.5	0.6
Images	3.5	1.5	2.0
Company's international activities	3.5	2.4	1.1
Voice transmission	2.6	1.3	1.3

Source: INPUT

Overall, the wide area networks currently in place are perceived to be ill-equipped to meet a wide range of future needs. As mentioned earlier, current WANs are perceived to be inadequate to provide the wide area connections between LANs required to support the client/server infrastructures now being implemented.

Current WANs are also perceived to be unable to handle the increased throughput typically required over the next few years. The need for increased throughput arises from a number of sources, including:

- The adoption of distributed IT architectures
- The steady increase in the number of users requiring access to remote workstations or servers
- The growing adoption of forms of electronic trading
- The anticipated use of multi-media, requiring the ability to transmit images between workstations.

Changing business needs are widely forecast to produce a requirement for cost-effective multimedia transmission capability within the next three years, something that is generally absent from corporate data networks at present.

There is also a growing perception that communication should be conducted on a person to person basis rather than on a server to server basis. Associated with this requirement, is the need for the use of wide area communications to be simplified considerably, to make it more accessible to users. Routing of data is perceived to be a very cumbersome process at present.

In addition, many corporate data networks are still perceived to have poor international coverage, and received an unsatisfactory rating in terms of their cost-effectiveness or value for money.

One of the areas where existing WANs were rated mostly highly was in their support for E-mail. However, many users now wish to go significantly beyond E-mail and be able to communicate via data, voice, fax, and image on a desk to desk basis.

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Research Bulletin

A Publication from INPUT's Outsourcing Information Systems Programme – Europe

Vol.V, No.23 December 1994

Organisations Require Single Source IT Infrastructure Management

Many European outsourcing vendors perceive that it would be difficult for them to offer wide area network (WAN) outsourcing services, since they typically lack the WAN infrastructure to compete with the leading carriers. In addition, the WAN outsourcing market is perceived to be becoming more competitive, with the arrival of a number of North American telecommunications suppliers.

However, WAN outsourcing capability will be an important component of IT infrastructure management capability in the future, as organisations adopt increasingly distributed architectures. In addition, many organisations prefer to outsource the management of their IT infrastructure to a single source, rather than have to liaise with a number of different vendors.

In particular, users will:

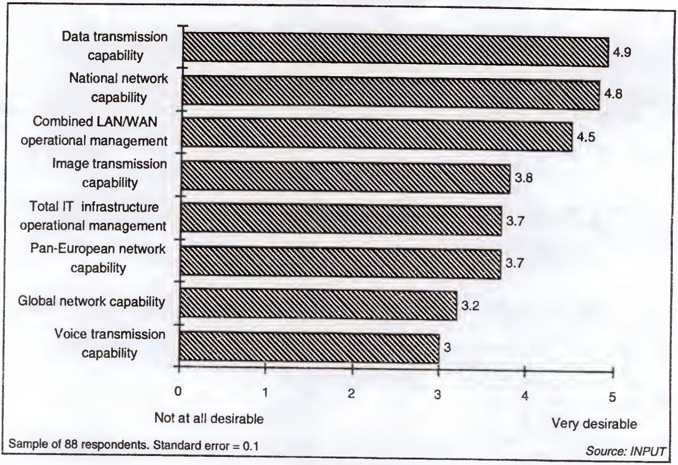
- Require vendors to provide combined LAN/WAN management capability
- Favour outsourcing vendors with a broad range of capability in preference to network management specialists.

Vendors Need to Offer Combined LAN/WAN Capability

Exhibit 1 lists the desirability of a number of potential characteristics of WAN outsourcing suppliers as perceived by a combination of senior executives and IT managers.

Exhibit 1

Desirability of Vendor Characteristics



Sample of 88 respondents. Standard error = 0.1

Source: INPUT

Wide geographic coverage remains an important characteristic for WAN outsourcing vendors. One of the principal expectations of senior executives is that their organisations will increasingly use wide area networking to facilitate electronic trading with customers and suppliers, independently of their location. Consequently, over 80% of the executives interviewed attached a high importance to pan-European network capability, and nearly 50% perceive global network capability to be important.

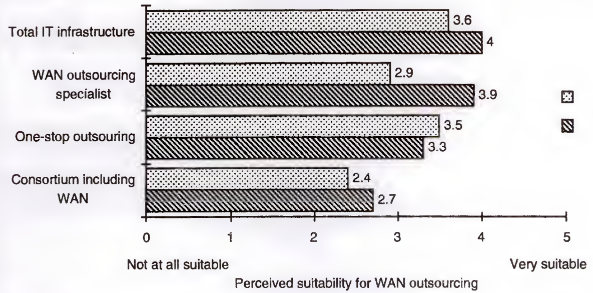
At the country level, senior executives and IT managers in France and Germany were particularly enthusiastic about the requirement for wide geographic coverage, while respondents in the UK were much less convinced of the need for WAN access outside their own country.

Combined LAN/WAN management capability was perceived to be extremely important to nearly 90% of respondents across Europe. In addition, the majority of respondents in Germany and the UK would like WAN outsourcing vendors to offer a complete IT infrastructure operational management capability.

This point is further illustrated in Exhibit 2.

Exhibit 2

Perceived Suitability of Vendor Types



Sample of 88 respondents. Standard error = 0.2

Source: INPUT

Senior executives show a clear preference for vendors with either a total IT infrastructure support capability or a one-stop outsourcing capability, including systems development.

IT managers are currently divided between favouring vendors with total infrastructure support capability and WAN outsourcing specialists. One reason why many IT managers currently favour WAN outsourcing specialists is because of the belief that few vendors currently possess the complete range of expertise required.

However, both groups of respondents show limited enthusiasm for consortia incorporating a WAN outsourcing specialist. Organisations in Europe tend to be wary of awarding outsourcing contracts to consortia, since they are unsure that relationships between potentially competing vendors will remain stable over the prolonged life of an outsourcing contract. In this way, the outsourcing market currently differs significantly from the systems integration market, where consortia are much more acceptable to potential clients.

Accordingly, in the future, vendors will need to combine WAN outsourcing with their datacentre, client/server and desktop services offerings. Similarly, the telecommunications vendors will need to develop a more broadly based outsourcing capability extending their services significantly beyond WAN management.

Major IT Outsourcing Vendors Preferred to WAN Management Specialists

Exhibit 3 lists the number of times each vendor was mentioned as being well suited to WAN outsourcing.

Exhibit 3

Principal Vendors Mentioned

Vendor	Europe	Germany	France	UK
IBM	22	12	4	6
EDS	13	2	8	3
Cap Gemini Sogeti/debis	12	3	4	5
Digital	7	5	1	1
British Telecom	5	–	–	5
Bull	5	–	5	
ICL	5	–	–	5

Source: INPUT

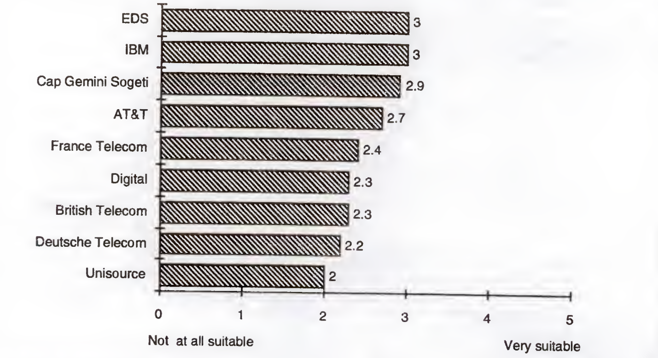
The most frequently mentioned vendors were not the carriers, but the leading international IT outsourcing vendors: IBM (including Axone in France); EDS; and Cap Gemini Sogeti.

The national carriers, Deutsche Telecom, France Telecom and British Telecom, only received mentions in their own national markets. Even here, the level of recognition that they received as potential WAN outsourcing suppliers was only comparable with that received by the national equipment vendors: SNI; Bull; and ICL.

In addition, respondents were asked to rate the suitability of each of a number of named vendors as potential suppliers of WAN outsourcing. The results are shown in Exhibit 4.

Exhibit 4

Perceived Suitability for WAN Outsourcing: Europe



Sample of 88 respondents. Standard error = 0.1

Source: INPUT

One of the reasons why the carriers receive comparatively low ratings is that each of the national carriers receives a very low rating outside their country of origin. It will be difficult for any of these vendors to become majors player at the European level, until they can develop more broadly-based recognition of their capability.

Nor are these vendors automatically regarded as the most suitable suppliers of WAN outsourcing services within their own national markets. For example, IBM receives a higher rating than Deutsche Telecom in Germany, and IBM, Hoskyns and EDS each received slightly higher ratings than British Telecom in the UK.

Accordingly, it appears that the carriers, as well as the traditional IT outsourcing vendors, have yet to develop convincing WAN outsourcing offerings.

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Vendor Profile

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January 1995

AT&T Offers Increasing Range of Outsourcing Options in Europe

The major telecommunications companies have so far played a comparatively minor role in the European outsourcing market. In particular, the ability of these vendors to offer pan-European wide area network management services, is still being severely impeded by the monopoly on basic carrier services across much of Europe. At the same time, the cost of high bandwidth in Europe remains a strong impediment to the use of inter-site multimedia applications.

However, once high bandwidth ATM-based services become widely available at a much reduced cost in Europe, this will provide a strong incentive for organisations to outsource much of their wide area network provision.

In future, it will be increasingly important for outsourcing vendors to offer combined telecommunications and IT capability and the telecommunications vendors will become more important in the IT outsourcing market. AT&T has already made its first move into IT outsourcing in the US. In August 1994, AT&T signed a major outsourcing contract with Delta Air Lines in the US, initially guaranteeing revenues for the joint venture company of $2.8 billion over a 10-year period.

AT&T is also building up a growing outsourcing capability in Europe. At present, the company's key activities in Europe include:

- Establishing an outsourcing centre of excellence
- Focusing on subsidiaries of US multinationals
- Establishing a joint venture with Unisource

Establishing an Outsourcing Centre of Excellence

AT&T has most of the building blocks required to offer a comprehensive outsourcing service in Europe, but until now these activities have been highly fragmented and marginal. The main components of a comprehensive outsourcing offering include:

- AT&T Istel's mainframe datacentre management capability and experience in sectors such as healthcare and manufacturing

- AT&T GIS's client/server based expertise and geographic coverage in support of distributed IT architectures
- AT&T's wide area network management capability

AT&T is now in the process of assembling a new business unit: Networks and Business Solutions, that will work across each of these subsidiaries. AT&T Networks and Business Solutions will act as a centre of excellence, providing specialist consultancy and pre-sales skills to assist in co-ordinating support for outsourcing opportunities that require a range of expertise beyond the capability of any individual subsidiary.

Over the next few years, outsourcing vendors will need to develop offerings combining wide area and local area network management. At present, AT&T appears reluctant to go beyond the management of routers connected to LANs, since this requires a major field engineering presence for maintenance of LAN associated equipment.

Nevertheless, it is likely that AT&T will offer a combined LAN/WAN network management service in Europe within five years, assisted by AT&T GIS. AT&T is trying to develop the synergies between its subsidiaries. AT&T currently uses AT&T GIS for some on-site maintenance services and, in return, manages AT&T GIS's wide area network.

AT&T expects some of the intelligence currently resident in local area networks to migrate to the wide area network in the future. For example, AT&T has an agreement with Lotus that has enabled the company to install the Notes product in its US network nodes. This enables AT&T to provide an enhanced network service based on Notes, providing organisations with access to Notes facilities via their wide area networks.

Focusing on Subsidiaries of US Multinationals

AT&T has established a core network in Europe. This core network consists of 2 Mbps circuits connected via NET multiplexers.

The network provides access to most countries within Europe. However, the number of European nodes in this network remains limited. While AT&T has ten major nodes in the UK, the company currently has less than five nodes in each of France and Germany.

The main services that AT&T offers over this network are:

- X.25
- frame relay
- managed bandwidth

While there is considerable demand for X.25 based services, AT&T perceives its frame-relay-based services to be the fastest growing area and one where the company potentially has difficulty in keeping up with demand. Although AT&T does not currently offer an ATM-based service in Europe, the frame relay service will be upgradeable to an ATM-based service in the future.

AT&T is trialling ATM-based services in the US but has yet to introduce these within Europe, where the high cost and low availability of high bandwidth circuits remains a problem for wide area network outsourcing vendors.

AT&T also provides vsat satellite services to supply access to locations where the region's indigenous telecommunications services are inadequate to meet customer needs.

The European network is managed from two Global Network Management Centres (GNMCs) located in Redditch, UK and Amsterdam. AT&T's network management systems are currently based upon the ACCUMASTER network management product. However, the company is in the process of phasing out the ACCUMASTER product in favour of a network management system based on OpenView.

The GNMCs provide:

- Fault management and performance management
- Configuration management and change control
- Single currency billing

The NET multiplexers provide dynamic adaptive routing within the network independently of the GNMCs.

AT&T sees its present market opportunity divided into four main segments:

- US multinationals wishing to retain their own corporate networks but seeking circuit provision in Europe
- US organisations intending to retain management of their US wide area network in-house but needing a partner to provide a managed network service for them in Europe
- Organisations seeking to outsource the provision and management of their wide area networks
- Organisations seeking to outsource all of their IT function including the provision and management of their wide area networks

At present, AT&T's activity in Europe is dominated by the requirements of US-based organisations looking for assistance in Europe. AT&T typically manages the European network for such clients and provides the client with a terminal running StrataView to provide the client with an independent view of the network.

AT&T has approximately 100 network management contracts in Europe. These each have a typical value of approximately $1m per annum.

AT&T aims to rationalise clients' existing networks and migrate them onto a shared platform providing economies of scale. AT&T offers a range of professional services to assist clients in migrating from their current network infrastructure to a shared platform, including:

- Network management operations analysis
- Network design and planning
- Project engineering and management
- Network management training

Network audits play a significant role in generating new managed services opportunities for AT&T.

Examples of current clients include:

- WORLDSPAN Global Travel Information Services
- Davis Service Group
- Equifax Europe
- Fisher-Rosemount
- Fort Vale Engineering Ltd
- Transport Development Group

AT&T has a five-year contract with WORLDSPAN in Europe, valued at $50m. WORLDSPAN provides worldwide connectivity between 370 host organisations and approximately 12,000 travel agencies, tour operators and travel consolidators, covering airline reservations, hotel bookings and car rental.

AT&T provides WORLDSPAN with a managed X.25 packet switching service based on AT&T's backbone network and connection to public data network access gateways in 14 European countries.

The Transport Development Group consists of 35 operating companies active in the UK, France, Germany, the Netherlands and Spain. AT&T provides primarily X.25 managed services with the aim of connecting the principal computer centre in Birmingham, UK, operating business units, clients and suppliers.

AT&T provides frame relay services to Fisher-Rosemount, covering 61 locations in North America, 20 locations in Europe, and a number of locations in South East Asia. The network management services provided cover the core network through to management of router configuration, and database maintenance, for Cisco routers at each company location.

AT&T's Extended Connectivity Option (ECO) within the frame relay service provides, and manages, Cisco routers connected to the customer's local area networks. ECO can support the following protocols:

- TCP/IP
- DECnet
- DEC Lat
- IPX
- Source route bridging (SNA)

Establishing a Joint Venture with Unisource

One of the principal difficulties faced by AT&T in Europe is access to megabit lines. At present, AT&T is typically heavily dependent on the national PTT's for provision of lines.

AT&T is forming a joint venture company with Unisource, combining AT&T's European Business Communications Services business unit with Unisource's activities in data, satellite and voice transmission. AT&T believes that the formation of this new company will improve AT&T's access and development within Switzerland, Sweden, the Netherlands and Spain, since Unisource is jointly owned by the PTT's in these countries.

Since it has yet to establish an extensive network in Europe, it is difficult for AT&T to be strongly cost competitive with other service providers. Indeed there is a danger that AT&T's lack of nodes, providing local access to its core network, will make the company uncompetitive on price. To avoid this handicap, AT&T costs its service provision to new customers assuming that a local node already exists even where this is not the case. In this way, AT&T avoids making the first customer within a region incur the full cost of investment in new network nodes and its own service uncompetitive on price.

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Research Bulletin

A Publication from INPUT's Outsourcing Information Systems Programme – Europe

Vol. VI, No. 1 1995

Change in Critical Success Factors Drives Outsourcing in Life Assurance Sector

Traditionally, the insurance sector has been comparatively reluctant to adopt IT outsourcing. In 1994, the insurance sector was estimated to account for outsourcing revenues of $330 million in Europe, less than 8% of the total IT outsourcing market.

However, the insurance sector is now facing a period of intense change and several major applications operations contracts have recently been signed in Europe as organisations endeavour to reengineer their business processes.

The pace of change in the life assurance sector is now accelerating. In the short-term, this is being driven by regulatory changes in the U.K. market. However, the resulting drive for substantial increases in productivity in the U.K. will subsequently have an impact on life assurance organisations throughout Europe. Although there is as yet little competition between life assurance companies at the European level, any extensive reengineering of the life assurance sector in the U.K. is likely to be emulated elsewhere in Europe. In particular, the level of productivity in the life assurance sector in Germany appears to be low, a situation which could lead to the extensive adoption of outsourcing there.

Overall, the high level of conservatism, and reluctance to outsource, of the life assurance sector may be about to change. The industry is facing a period of intense competition. In particular:

- The growth rate in new policies is declining rapidly
- Regulatory pressures in the U.K. will change the nature of competition
- This will create opportunities for outsourcing vendors.

Life Assurance Growth is Declining

Exhibit 1 shows the growth in new policy numbers and premiums in the U.K. over the last five years.

Exhibit 1

U.K. Life Assurance

Year	New Policies (number)	Growth (%)	New Premiums (£m)	Growth (%)
1989	11388	–	10321	–
1990	9709	(15)	11565	12
1991	9319	(4)	14690	27
1992	9067	(3)	17529	19
1993	7941	(12)	19066	9
1994*	6590	(17)	16770	(12)

** = estimated*

Source: ABI

Growth rates in new life assurance premiums have declined steadily since 1991. The level of new premiums in 1994 has been estimated on the basis of performance in the first three quarters of the year. On this basis, the industry appears to be heading for a significant reduction in new premium income compared to 1993.

Whilst the 1994 reduction in premium income might be considered an exceptional case, attributable to a year in which the industry attracted a considerable amount of criticism concerning its sales methods, the number of new policies has been declining for some time. Much of the cost in the life assurance sector is associated with the selling and initial administration to establish new policies. The reduction in the number of new policies sold and administered could be expected to lead to a significant reduction in the number of sales and administrative staff within the industry. However, while this has begun to occur within the sales channel, there have yet to be significant redundancies within life assurance administrative staff.

Regulatory Pressures will Change the Nature of Competition

Another traditional feature of the life assurance sector has been its immunity from cost pressure. Indeed until recently companies have been forbidden by the regulator from disclosing the commissions paid to sales personnel and intermediaries and their own internal administrative charges. This situation has led to the industry paying comparatively little attention to its cost structure.

However, since January 1995 the regulatory environment in the U.K. changed dramatically. While all companies are still required to project the same rates of investment growth, organisations are now required to disclose their sales commission charges and their administration charges to their prospects.

This will radically change the nature of the critical success factors in the life assurance sector. Whereas sales force coverage, including intermediaries, and the speed with which a policy could be authorised, were possibly the most important factors in the past, the principal objective criterion on which potential customers will now be able to judge suppliers of life assurance will be their charge structure.

Hence the basis of competition in the industry has changed overnight from the sales person's credibility to the cost structure of the policy provider.

This is expected to produce a major shake-out in the industry and dramatically reduce the number of companies administering their own policies in the U.K..

Exhibit 2 compares some of the key statistics for organisations offering life assurance in France, Germany and the U.K..

Exhibit 2

Life Assurance Statistics, 1992

	France	Germany	U.K.
Number of life companies	147	326	196
Total gross premiums ($ Bn)	52	52	77
Number of employees (000's)	124	255	260
Gross premium per employee ($ 000's)	420	205	295

Source:INPUT

While the present shake-out only immediately threatens the U.K. market, companies in Germany clearly face a similar threat should they be equally judged on their relative efficiency in a European life assurance market of the future.

Opportunities for Outsourcing Vendors

In the past, the level of outsourcing activity in the insurance sector has been very low. Some examples of existing contracts are shown in Exhibit 3.

Exhibit 3

Contract Examples

Client	Vendor	Type of Contract
INA	EDS	Applications operations
Marsh & McLennan	Andersen Consulting	Global applications operations
Target Life	Unisys	Applications operations
Sturge	Data Sciences	Data centre management
Sedgwick	Data Sciences	Infrastructure management
GRE	IMI	Application maintenance management

Source: INPUT

Typical contracts have been to assist the smaller insurance companies in adopting new IT infrastructures. In addition, the insurance sector exhibited a need for application maintenance management services to assist companies in migrating between applications. Indeed, the longevity of products in the life assurance sector was a key factor leading to the low rate of adoption of IS outsourcing.

Systems relating to the management of an individual life assurance product need to remain in place for a minimum of 20 years. This longevity, together with the current change in the basic structure of the life assurance sector in the U.K. now presents a number of opportunities to outsourcing vendors.

The number of life assurance companies administering their own policies in the U.K. will reduce significantly, possibly halving over the next three years. However, even if a company closes its doors to new business, it still needs to administer existing policies for many years. Activities involved include:

- Collection of committed premiums
- Liaison with existing policy-holders
- Administering policy terminations and early surrenders.

Since these activities must be continued, the supplier has a choice of options including:

- Selling its life assurance business to another vendor
- Continuing to sell policies but subcontracting their administration to a low cost operator
- Attempting to become one of the low-cost administrators
- Exiting the business but subcontracting the administration of the existing policy portfolio.

Accordingly, outsourcing vendors can respond by offering a range of outsourcing services, from business operations outsourcing through applications operations outsourcing, to transition outsourcing and application maintenance management.

The most ambitious of these options is to offer a complete business operations outsourcing service on behalf of insurance companies. This would entail the outsourcing vendor providing both information systems capable of delivering low administrative costs and also the administrative personnel. It is likely that this is an opportunity being investigated by a number of vendors.

This scenario has the potential to create a business operations outsourcing opportunity worth in excess of $100 million per annum, and significantly increase the significance of the insurance sector in the outsourcing market.

For example, Andersen Consulting is likely to adopt this business operations focus since it follows one of their current approaches of developing facilities that can be shared by a number of players in an industry and which target business operations rather than purely IT outsourcing.

Since it is unlikely that any vendor could completely set up such a facility on its own, a number of outsourcing vendors are believed to be seeking acquisitions or joint ventures with suitable partners already active in the life assurance sector to offer business operations services.

It is also probable that there are insurance companies that need to improve their cost base, but still wish to retain their administration in-house. These companies are candidates for major systems integration or application operations outsourcing contracts with vendors offering considerable business reengineering capability and knowledge of best practice in the insurance sector. Examples of organisations that have undertaken such contracts include INA and Marsh & McLennan.

In addition, organisations acquiring other insurance companies will experience initial difficulties in using common information systems to administer policies across organisations. This again results in opportunities ranging from transition outsourcing of datacentres and application maintenance management through to a short-term business operations opportunity.

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Inland Revenue — Need for Rapid Change

The Inland Revenue considers that its history of applying information technology throughout the 1980's had been very impressive. The Inland Revenue Information Technology Office (ITO) was a confident organisation during this period and perceived itself to be largely self-sufficient.

By the early 1990's, the ITO had an annual budget of between $350 million and $450 million, of which 40% was incurred on capital expenditure and 60% on operating expenditure. The organisation employed approximately 2,700 personnel and served a population of 50,000 networked users.

The staff of the ITO were deployed across three development centres and thirteen datacentres.

However, by the early 1990's, the pressure on the department was beginning to mount. New technology was a major factor here. The pace of change had quickened and personal computer technology was, and still is, fundamentally changing every two to three years. This in turn has considerably increased the expectations of the ITO's clients. These users now expect increased use of IT, delivered more quickly, with increased quality (including higher functionality, better integration, improved interfaces, high reliability and response times) at a lower price.

In response to these demands, the Inland Revenue:

- Conducted an internal benchmarking exercise
- Concluded that a new style of service delivery was required
- Sought a step change in cost effectiveness and development timescales.

Internal Benchmarking Exercise

The organisation conducted an internal benchmarking exercise and concluded that there was considerable scope for improvement. A number of options were considered including:

- Use of external subcontractors on a project by project basis

- Improving internal productivity
- Rationalising datacentres.

However, ITO management perceived that there were a number of disadvantages to these approaches to the problem, namely:

- IT service delivery was not considered to be part of the core business of the Inland Revenue.
- The productivity of the ITO was severely constrained by the legal restriction preventing the ITO from trading outside the Inland Revenue. This has a major potential impact on datacentre usage and productivity.
- A very substantial investment in tools and techniques would have been required to enable the ITO to adopt best practice in systems development; however, as a government organisation, the ITO was severely constrained in its access to cash for investment purposes.

New Style of Service Delivery Required

Accordingly, the management of the ITO decided that a new style of delivery of IT was required to make the organisation a world-class service provider, and began to investigate the relevance of outsourcing to the organisation.

The timetable by which the Inland Revenue ITO adopted outsourcing is listed in Exhibit 1.

Exhibit 1

Inland Revenue: Timetable of Events

Date	Event
March 1992	Began informal discussions with outsourcing vendors
July 1992	Staff informed of decision to adopt outsourcing
September 1992	Authorised to begin market testing by the Treasury
December 1992	Began formal procurement process
November 1993	Announced identity of preferred strategic partner
May 1994	Contracts signed
July 1994	1,100 personnel transferred to EDS
January 1996	900 development staff to be transferred to EDS

Source: Inland Revenue

Overall, the market investigation and vendor selection process took nearly $2^1/_2$ years. Since the ITO extensively used the services of external advisers, including management consultants and solicitors, throughout this process, it was also presumably extremely costly.

In retrospect, the ITO believes that the process was too lengthy. In particular, there were the major problems of keeping internal staff informed, and maintaining their morale, over a period of two years.

The Inland Revenue attempted to minimise the cost of tendering to outsourcing vendors, since it expected a high level of interest from the vendor community. Accordingly, the ITO did not produce a formal Invitation to Tender (ITT) document until the shortlist stage. However, the document, when finally produced, consisted of 10,000 pages.

By this time, the ITO had already spent nine months in informal discussions with a number of outsourcing vendors. This stage was very important to the Inland Revenue. By the time that the formal procurement process began, the ITO had a clear idea of the approach it wished to take and had eliminated many of the potential shortcomings of its initial plans.

In addition, the Inland Revenue perceives that this approach has the advantage of giving the vendors time and information on which to base more informed formal proposals and, hence, raises the quality of proposal received. The disadvantage is that it is potentially a major sales overhead for any organisation wishing to tender.

The Inland Revenue originally envisaged that the functions of its ITO would be transferred to its preferred supplier over four stages, with a requirement on the vendor to demonstrate improved value for money at each stage prior to its transfer.

However, EDS proposed that the transfer of the ITO's functions take place in two stages, rather than four, and this proposal has now been accepted.

In July 1994, the Inland Revenue's datacentres and associated personnel were transferred to EDS. Subject to a review currently scheduled for August 1995, a further 900 development staff will be transferred to EDS on January 1, 1996.

Step Change in Cost-Effectiveness and Development Timescales Required

The vendor selection criteria listed by the ITO include:

- Commercial stability
- Track record
- Technical capacity
- Ability to maintain high levels of confidentiality
- Financial value of the bid.

The vendors principally involved were:

- CSC
- Digital
- EDS
- IBM
- ICL.

Some vendors established consortia to acquire the range of skills and capacity required. For example, Digital formed a consortium consisting of itself, Barclays Computer Operations (BCO) and Logica. However, the Inland Revenue was believed to favour a contract with a single organisation.

The CCTA, the central government advisory body, is known to favour the use of single vendors since the introduction of a consortium is perceived to significantly increase the level of risk. This is particularly true for long contracts since it requires an assumption that, in the example of the Inland Revenue, a number of potentially competing companies will all remain financially sound and will remain on an amicable footing for a minimum of 10 years, and possibly much longer if the contract is subsequently renewed.

The selection criteria in the case of the Inland Revenue contract would have been particularly risk-averse because of:

- Its significance as one of the early central government outsourcing contracts
- The size of the contract — approximately $300 million per annum
- The nature of the information processing activity; tax records are extremely confidential and require high levels of security in their processing and storage.

This risk aversion undoubtedly acted against European outsourcing vendors, none of whom could demonstrate the management of an external $300 million per annum outsourcing contract. To establish the track record of potential suppliers, the Inland Revenue contacted approximately 30 reference clients of the vendors shortlisted.

The principal objectives that the Inland Revenue sought to meet via outsourcing were as follows:

- A major step change in the cost-effectiveness of its IT operations
- A major step change in the delivery time for new systems
- Rapid access to new tools and techniques for system enhancement and provision
- The provision of new career opportunities for its IT personnel.

These four objectives have now been incorporated, in the form of metrics for each, within the agreement with EDS.

Overall, the Inland Revenue expects to achieve:

- Cost savings of 15% - 20%
- A telescoping of development lead times
- Improved research and development
- Improved career opportunities for IT personnel.

However, the Inland Revenue believes that it is important to maintain sufficient personnel and skills within its own Information Technology Office to liaise with EDS on equal terms. In particular, the Inland Revenue believes that it must maintain:

- A high level of architectural skills
- A contract management team.

At present, the Inland Revenue has retained approximately 300 personnel to perform these functions, but expects this number to decline to less than 100 within two years.

The Inland Revenue also perceives that it is important that contract management and liaison is performed at a number of levels, including:

- At board level, between the Inland Revenue board and the EDS board of directors

- At account control level, between the two account management teams
- Representatives of the users receiving the IT services.

The Inland Revenue wished to develop a close partnership with its chosen vendor, rather than an arm's length relationship. For example, the Inland Revenue wanted to adopt open book accounting for the contract, and has incorporated a revenue sharing mechanism into the contract to cover use of spare capacity within its former datacentres.

This Research Bulletin is issued as part of INPUT's Outsourcing Programme – Europe. If you have any questions or comments on this bulletin, please call your local INPUT organisation or John Willmott at:
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Major Vendors Target Austrian Outsourcing Market

At present, the Austrian market is one of the less developed outsourcing markets in Europe. Broadly speaking, the current stage of development of the Austrian outsourcing market is comparable to the Italian outsourcing market of two years ago.

The Austrian outsourcing market is characterised by:

- A number of major processing services organisations owned by banking co-operatives
- A shortage of large multinationals
- A conservatism in adopting outsourcing and in dealing with newly established foreign vendors

In addition, the Austrian economy is not yet feeling the same intense cost pressure as the major European economies. This takes away some of the short-term impetus behind outsourcing.

However, this situation is about to change as many of the leading outsourcing vendors begin to position themselves in Austria, providing a major boost to the level of awareness of outsourcing.

The key trends in the Austrian outsourcing market will be:

- Initial activity concentrated in the manufacturing sector
- The subsequent emergence of opportunities in the services sectors
- Increasing dominance of the market by the major international outsourcing vendors

Initial Activity in the Manufacturing Sector

The manufacturing sector is currently the principal source of opportunity for outsourcing vendors in Austria. In particular, organisations facing financial difficulties and subsidiaries of foreign-owned organisations are particularly good prospects for outsourcing vendors.

A number of outsourcing contracts have already been signed with manufacturing organisations in Austria, and the Austrian manufacturing sector is unlikely to remain immune from cost pressures in the medium-term.

For example, Philips C&P already has a number of outsourcing contracts with manufacturing companies, and EDS has signed one contract with a textiles manufacturer experiencing financial pressures.

In addition, many manufacturing companies in Austria will undergo the transition between centralised, mainframe-based architectures and client/server architectures, leading to transition outsourcing opportunities followed by client/server systems management opportunities. In particular, Austrian manufacturing organisations will be migrating to SAP R/3 over the next few years. This will create both transition outsourcing and SAP outsourcing opportunities.

Accordingly, the manufacturing sector in Austria will undoubtedly produce outsourcing opportunities in the same way as the manufacturing sector is currently doing in Germany. In time, the focus of these contracts can also be expected to switch from an initial focus on cost-cutting towards an emphasis on business reengineering.

Emergence of Opportunities in the Services Sectors

In the medium-term, significant opportunities will begin to emerge in the financial services and business services sectors. While the prime outsourcing prospects in these sectors are likely to be experiencing financial pressures, their initial motivations for outsourcing are likely to include a strong need for adoption of best business practices and leading edge technology.

The emergence of the need for business reengineering in Austria is illustrated by the predicament of Austrian Airlines, which has in 1995 moved its accounts department to Bombay as part of a streamlining programme.

In addition, if the trends in the development of the outsourcing market in Austria follow a similar pattern to those elsewhere in Europe, for example Italy, it is probable that one or more of the major outsourcing vendors, such as EDS, will acquire an Austrian processing services co-operative. Organisations serving the financial services community, such as Spardat, or Management Data, are prime prospects for acquisition in the medium-term.

The size of the Austrian outsourcing market is estimated in Exhibit 1.

Exhibit 1

Outsourcing Market: Austria 1994-1999

	Market size Sch m 1994	Growth 94-99 (%)	Market size Sch m 1999
Platform operations	45	12	80
Application operations	120	18	275
Total systems operations	165	16	355
Desktop services	45	25	140
Network management	45	15	95
Applications management	20	25	60
Total IS Outsourcing	280	18	640

Source: INPUT

The growth rates shown here are conservative and assume a steady increase in small to medium-sized contracts. If one of the major vendors is successful in winning a major applications operations contract, then the growth rate could be double that shown in Exhibit 1.

Increasing Dominance of Multinational Outsourcing Vendors

The Austrian outsourcing market is currently in its formative stages, with the major outsourcing vendors beginning to focus attention on the market. The market should show significant growth as the major non-indigenous vendors begin to take over leadership of the market.

Exhibit 2 lists the leading vendors in the Austrian outsourcing market at the present time.

Exhibit 2

Leading Vendors
Austrian Outsourcing Market: 1994

Vendor	Revenues Sch m 1994	Market share (%) 1994
AI Informatics	70	25
IBM	60	21
Philips C&P	35	13
Spardat	30	11
EDS	12	4
Total listed	207	74
Total market	280	100-

Source: INPUT

At present, the major outsourcing vendors are only just beginning to position their outsourcing offerings in Austria and they have yet to fully establish their presence.

It is likely that they will do so within two years, both by winning major contracts and by acquiring local players. By 1999, it is probable that vendors such as IBM and EDS will dominate the Austrian outsourcing market, having overtaken local vendors who will find it difficult to organically develop the financial reengineering and business consulting skills necessary to win major contracts.

The level of activity of a number of leading, or potentially significant, players in the Austrian outsourcing market is shown in Exhibit 3.

Exhibit 3

Outsourcing Activities: Austria

Vendor	Outsourcing Activity
AI Informatics	All clients in manufacturing sector SAP outsourcing is one major focus
IBM	Has won one outsourcing contract in 1994
Philips C&P	Have 5 outsourcing contracts in the manufacturing sector Major contract is with ABB
Spardat	Owned by Bank Austria Provides IT services to approximately 30 banks.
EDS	One contract with failing textiles manufacturer Building up SAP expertise Establishing contacts and personal networking Probably trying to purchase local supplier of services - most likely target is one of banking processing services companies
debis	Have joint venture with local datacentre No external clients Will probably target SAP outsourcing
CSC	No presence in Austria except through Ploenzke No outsourcing contracts at present Have developed GSM billing system for Austrian PTT and expect to take over management of one of the PTT's datacentres
Siemens-Nixdorf	Likely to move quickly in Austria Probably will adopt reengineering led approach to outsourcing

Source: INPUT

Vendors' strategies will differ markedly. The local vendors and debis Systemhaus will adopt incremental approaches to outsourcing. For example, debis Systemhaus is likely to adopt a bottom-up strategy in Austria and target areas such as SAP outsourcing, application management and distributed systems management.

On the other hand, EDS is likely to follow a similar strategy to that taken by the company elsewhere in Europe and target a large co-sourcing contract with a major organisation in Austria while simultaneously seeking to acquire a leading Austrian vendor.

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Vendors Position Themselves for Leadership in Client/Server Systems Management

There has been considerable activity in many areas of the European outsourcing market during the last twelve months. However, the area of greatest activity is undoubtedly client/server systems management. Here many of the existing outsourcing leaders and a number of new entrants are making significant investments in order to establish a leadership position.

In particular, companies such as Hewlett-Packard, Digital and Olivetti, that have lacked the facilities to become major players in the mainframe datacentre outsourcing arena, are now strongly targeting this new outsourcing opportunity.

Overall, the competition in this area will be intense with many participants from among the existing outsourcing vendors, equipment vendors, telecoms vendors, and dealers all endeavouring to capture a significant share of this emerging opportunity. This research bulletin compares the capabilities of a number of potential leaders in client/server systems management, namely: Olivetti, Hewlett-Packard, Digital, Cap Gemini Sogeti, and SHL Systemhouse against a number of criteria critical for success in client/server systems management.

These critical success criteria are the vendor's ability:

- To match its service portfolio to the client requirement
- To automate service delivery to drive down support costs and ensure price-competitiveness with other vendors
- To demonstrate improved end user productivity
- To match the client organisation's required geographic coverage.

Scope of Services

Many organisations will not want to purchase client/server systems management in isolation but will require a broader range of services. For example, organisations making the transition from mainframe-oriented infrastructures to client/server architectures may require:

- A vendor capable of acquiring, and running services based on existing mainframes

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- Assistance in designing and building the new infrastructure
- Application management services for legacy, or new, applications
- Systems management of the client/server infrastructure.

An assessment of the capability of each vendor to deliver these services is shown in Exhibit 1. The ability to manage client/server infrastructures locally is relatively commonplace and so in Exhibit 1 the vendors have been assessed on their ability to conduct client/server management remotely.

Among the vendors discussed in this bulletin, Cap Gemini Sogeti and SHL Systemhouse have the highest levels of capability to provide the entire service portfolio.

Cap Gemini Sogeti has well-established offerings for datacentre management, application management and client/server implementations. This wider capability is critical to Cap Gemini Sogeti's current success in distributed systems management.

Cap Gemini Sogeti claims 1994 revenues of approximately $140 million for its distributed systems management services. Many of the company's distributed systems management contracts are accompanied by a wider range of outsourcing services.

In addition, INPUT's research has shown that many organisations that initially outsource mainframe operations, subsequently seek to outsource their client/server infrastructures.

Exhibit 1

Overall Service Capability

Capability	Olivetti	Hewlett Packard	Digital	Cap Gemini Sogeti	SHL Systemhouse
Datacentre management	Medium (Via Syntax)	Low	Low - Medium	High	High
Client/server implementation	High	High	High	High	High
Remote client/server management	Medium - High	Medium - High	Medium - High	Medium	Medium - High
Application management	Low - Medium	Low	Low - Medium	High	Medium - High

Source: INPUT

SHL Systemhouse also has a broad service portfolio compared to the equipment vendors listed. The company does not promote application management as a separate offering in the manner of Cap Gemini Sogeti, but performs application management as a component of its transformational outsourcing service offering.

Olivetti has the best all-round portfolio among the three equipment vendors, since the company has a mainframe datacentre management capability through its Syntax subsidiary. However, Olivetti may have more difficulty than Cap Gemini Sogeti and SHL Systemhouse in demonstrating to prospects its ability to co-ordinate its various offerings into a single coherent service.

Overall the two traditional outsourcing vendors Cap Gemini Sogeti and SHL Systemhouse have a higher level of ability than the three equipment vendors to provide the broad outsourcing capability often required in transition outsourcing. However, the ranking is very different when the vendors are judged solely on their current ability to deliver remote client/server systems management.

In particular, Cap Gemini Sogeti is lagging behind the other vendors in the implementation of its infrastructure for remote client/server systems management. This infrastructure is still at the pilot stage and Cap Gemini Sogeti is currently the weakest of the five vendors in its ability to demonstrate remote client/server systems management.

An assessment of each vendor's client/server systems management capability by service component is listed in Exhibit 2.

Exhibit 2

Capability by Principal Service Component

Capability	Olivetti	Hewlett Packard	Digital	Cap Gemini Sogeti	SHL Systemhouse
Consulting and planning	High	High	High	High	High
Asset management	Medium - High	Medium - High	Medium - High	High	High
Financing	Medium - High	Medium - High	Medium - High	High	High
Procurement	High	Medium - High	Medium - High	Medium - High	High
Installation and staging	High	High	High	Medium - High	Medium - High
Remote LAN/server management	High	High	Medium - High	Medium	High
Remote client management	Medium - High	Medium - High	Medium - High	High	High
Update management	Medium - High	High	High	Medium - High	High
Help-desk services	High	High	High	High	High
Equipment maintenance services	High	High	High	Medium	Medium - High

Source: INPUT

All of the vendors listed aim to provide complete portfolios of client/server systems management and support services. However, while most of the vendors can provide a largely complete service using their own delivery mechanisms, Cap Gemini Sogeti has a comparatively high level of need for partners in delivering its client/server support services. Unlike the other vendors, Cap Gemini Sogeti cannot deliver equipment maintenance without external assistance and lacks the procurement experience that would typically be found in a dealer environment.

Accordingly, Cap Gemini Sogeti will tend to succeed with clients where a broad outsourcing capability is required in addition to client/server systems management. However, the equipment vendors and SHL Systemhouse are better positioned where the client is solely focusing on client/server systems management. Digital, Olivetti and Hewlett-Packard are particularly well-positioned where the client is evolving towards client/server systems management from a multi-vendor customer services background.

SHL Systemhouse is very well-positioned in terms of its capabilities and service portfolio, and has a significant UK presence. In addition, SHL Systemhouse is targeting organisations with a major presence across continental Europe and aims to build a major pan-European support capability in conjunction with one or more prospective clients. However, the company so far lacks the European coverage and presence of the other vendors.

Automation of Service Delivery

The concept of outsourcing client/server systems management will only become widely accepted by the user community when vendors can demonstrate significant real cost reductions without the need to invoke *hidden cost* based arguments. The automation of service delivery is the second necessity, after standardisation of the IT infrastructure, in order for vendors to demonstrate this ability to reduce support costs.

At present, a considerable proportion of client/server systems management service is delivered by on-site personnel. However, all of the vendors discussed are making considerable investments to reduce the need for on-site personnel.

Exhibits 3 and 4 provide assessments of the remote systems management capabilities of the five vendors.

Exhibit 3

Platforms/Protocols Supported Remotely

Platform/Protocol	Hewlett Packard	Olivetti	Digital	Cap Gemini Sogeti	SHL Systemhouse
Novell Netware	yes	yes	yes	yes*	yes
LAN Manager	yes	yes	yes	yes*	yes
Microsoft NT	yes	yes*	yes	yes*	yes
SNMP	yes	yes	yes	yes*	yes
Unix (TCP/IP)	yes	yes*	yes	yes*	yes
DOS/Windows	yes	yes	yes	yes	yes
Appletalk	yes	no	yes	no	yes
Digital VAX	yes	no	yes	yes	yes
IBM AS/400	yes	no	no	yes	yes

Notes: * *by mid '95*

Source: INPUT

The assessment for Cap Gemini Sogeti is based solely on discussions with the company and is based on anticipated capability rather than demonstrated capability. For each of the other four vendors, the assessment is largely based on their current ability to demonstrate remote systems management capability.

Exhibit 3 lists each vendor's current ability to manage platforms remotely.

Each of the vendors is working towards a broad remote platform management capability. At present, Hewlett-Packard and SHL Systemhouse have the broadest current platform management capability. However, in practice, these companies do not have substantial levels of business on each of these platforms.

For example, SHL Systemhouse still predominantly manages Netware and Unix environments, and Hewlett-Packard does not currently manage any Apple platforms from its UK network management centre.

Exhibit 4

Principal Tools Used

Function	Olivetti	Hewlett Packard	Digital	SHL Systemhouse	Cap Gemini Sogeti
Help-desk/trouble ticketing	In-house system based on Oracle database; migrating to Scopus	Remedy	In-house system	Remedy	Remedy
Network management	OpenView	OpenView	Polycenter/ NetView	OpenView	OpenView
Workstation management	Proxy and PC Anywhere	Norton Administrator	PC Duo	Proxy	PC Anywhere
Software distribution	SMS (planned)	Farpoint SMS (planned)	Software Utility SMS (planned)	Tivoli	SMS (planned)
Asset administration	Qualiparc	AssetView	Polycenter AssetWorks Software Utility	Assetpro (Remedy database)	
Automatic inventory updating	NetCensus		Polycenter AssetWorks	AssetPro NetCensus	

Source: INPUT

Digital does have a significant number of outsourcing contracts involving management of IBM AS/400 equipment, but so far manages these systems on-site rather than remotely.

Each of the vendors discussed has been making considerable investments to assemble a network of network management centres. Each of these centres must be capable of handling all of the elements of remote systems management in a highly integrated manner.

At present, this requires vendors to integrate a range of diverse systems management tools. The tools used by each of the vendors are listed in Exhibit 4.

It is important to note at this point that the choice of tools and the scope of remote systems management capability is rapidly evolving. Vendors are currently replacing existing tools and integrating new ones with considerable frequency.

Hewlett-Packard is one of the leaders in the development of a complete remote systems management toolset. However, each of the vendors listed in Exhibit 4 demonstrated highly integrated environments. Olivetti currently lacks a high level of integration between its network management and trouble-ticketing systems, a failing that is likely to be remedied in the coming months.

The ability to remotely conduct systems management can produce a considerable reduction in the need for on-site intervention. For example, Hewlett-Packard, Olivetti and SHL Systemhouse can manage each of the following functions remotely:

- Server administration
- Server back-up
- Software distribution
- Software asset recording.

At present, Olivetti can only remotely handle software distribution in an OS/2 environment, but plans to introduce Microsoft's SMS for software distribution in the future. This intention is shared by the majority of the vendors surveyed.

Olivetti also typically requires onsite personnel to handle the loading and unloading of physical media during back-ups. SHL Systemhouse, on the other hand, endeavours to persuade its clients to invest in jukebox systems reducing the need for physical manipulation of back-up media.

Olivetti is also able to collect equipment inventory details remotely, though the company still finds it initially necessary to place a physical identifier on each equipment item to assist its equipment maintenance engineers.

Improved End User Productivity

However, while the overall toolsets of the vendors are broadly comparable, there are some differences in emphasis reflecting slightly differing philosophies. In particular, it was noticeable that the traditional outsourcing vendors Cap Gemini Sogeti and SHL Systemhouse displayed a greater emphasis on client management and user support than Hewlett-Packard.

Olivetti's help-desk aims to route callers to a support analyst capable of beginning problem resolution within 20 seconds of receiving the call. If the support analyst is unable to resolve the problem within 15 minutes, then escalation procedures come into force. However, the initial analyst retains responsibility for the problem and for agreeing sign off of the problem with the caller.

All of the vendors discussed have a broadly similar capability to support the major shrink-wrapped packages currently in use. Similarly all of the vendors strongly promote their special relationships with vendors such as Microsoft and Novell.

Exhibit 5

Locations of European Network Management Centres

Country	Hewlett Packard	Olivetti	Digital	Cap Gemini Sogeti	SHL Systemhouse
France	Current	1995	Current	1995	
Germany	Current	Planned	Current	1995	
UK	Current	Current	Current	1995	Current
Italy	Current	Current & 1995			
Belgium	Current	Planned	Current		
Netherlands	Current	1995	Current	1995	Current*
Sweden	Current			1995	
Denmark	Current	1995			
Norway	Current				
Finland	Current				
Spain	Current	1995		1995	
Switzerland	Current		Current		
Austria	Planned				

*Notes: *Not available to new clients*

Source: INPUT

However, Digital appears to be particularly strong in this area. The company claims to support more than 60 standard PC software products and has very close support relationships with Microsoft, Novell and Lotus. Digital is also strongly moving into the area of software licence asset management.

A major problem in supporting client/server environments is the need for the help-desk to be able to support other proprietary, or in-house developed, applications.

Cap Gemini Sogeti potentially has an advantage here since the company offers application management services and will take over the support of existing in-house developed applications where required. In instances where the company does not provide application maintenance management, SHL Systemhouse ensures that all problems are routed through a single help-desk by taking over first-line help-desk support for in-house developed applications, routing second line support through to the appropriate in-house development team.

Appropriate Geographic Coverage

Exhibit 5 lists the locations of the vendors' European network management centres.

Hewlett-Packard is the current leader in establishing a major network of network management centres throughout Europe. Hewlett-Packard has implemented standard processes and toolsets to ensure the company's ability to provide common support to multinationals on a transnational basis.

Olivetti is also establishing a strong European network management infrastructure. The company's philosophy has been to rapidly establish network management centres to cover each of the various language groups in Europe.

SHL Systemhouse has seven network management centres worldwide, but six of these are located on the American continent. The company has also built a network management centre for sole use by a specific client in the Netherlands.

The siting of help-desk support is another consideration. Vendors need to decide whether to base application support teams in each country or in regional centres.

At present, Olivetti is handling application support within each country, but may decide to concentrate user support, possibly in Belgium, in the future. On the other hand, Digital has a multilingual User Application Support centre covering all of Europe from Utrecht. Cap Gemini Sogeti currently favours the national model but may decide to concentrate user support in language groupings in the future.

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Vol. VI, No. 5 1995

European Outsourcing Market Will Grow at 20% Per Annum

The European outsourcing market has been growing rapidly throughout the 1990s and there has been recent speculation in the press that this growth must soon slow down. It has even been suggested that the size of the European outsourcing market will begin to decline before the end of the century.

However, INPUT forecasts that the European outsourcing market will continue to grow rapidly over the next five years. This forecast is based on the evolution of a number of key market drivers, such as the increasing adoption of IT outsourcing as a strategic, rather than tactical tool and the complexity of managing distributed systems environments in-house. The current strengthening of these market drivers is stimulating outsourcing market growth.

While outsourcing lead identification is probably best approached on a company-by-company basis, each of these trends is more evident in some industry sectors than others. In particular:

- The insurance and discrete manufacturing sectors are in the vanguard of those industries taking a strategic approach to outsourcing
- The retail, process manufacturing and banking sectors are seeking assistance in managing their distributed IT environments
- The policies of the U.K. government are providing major opportunities in the public sector.

Insurance and Discrete Manufacturing Sectors Take Strategic Approach to Outsourcing

Until recently, the discrete manufacturing and insurance sectors have displayed quite different approaches to IT outsourcing. Although, the discrete manufacturing sector has always been at the forefront in the use of outsourcing in Europe, many of the early contracts in this sector were primarily concerned with phasing out, or reducing the cost of mainframe datacentres. On the other hand, organisations in the insurance sector typically wished to retain their mainframe datacentres. Consequently, the historical use of IT outsourcing in the insurance sector has been relatively low, and largely restricted to low value application management contracts.

However, these two sectors are now beginning to move more strongly towards the strategic use of outsourcing and a number of major application operations contracts have emerged in both sectors.

With the advent of changes in legislation, direct selling and heavily automated competitors, many insurance companies are facing considerable cost pressure and a need to introduce more competitive services and means of delivery. This is creating a major restructuring of the industry and generating major opportunities for IT outsourcing vendors. Major applications operations contracts have already been signed between EDS and INA in Italy and between IBM Systeme und Netze and Gothaer Versicherungen in Germany.

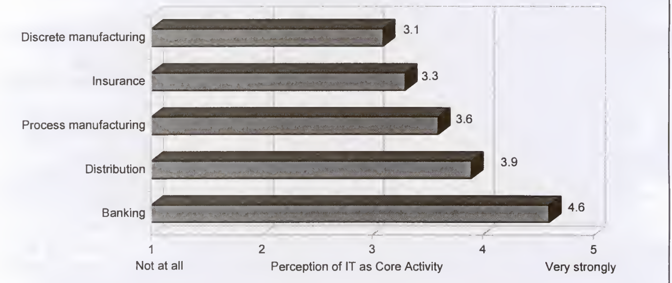
Additional major contracts will be signed in the insurance sector over the next few years. The current strong need for change by organisations within the sector is compounded by perceived in-house weaknesses in new system development and lack of understanding of new technologies.

Furthermore, the insurance sector, like the discrete manufacturing sector has a relatively low regard for IT as a core activity.

Exhibit 1 shows the extent to which managers in each of a number of industry sectors perceive IT to be a core activity.

Exhibit 1

Extent to which IT is Perceived as Core Activity



Sample of 88 respondents. Standard error = 0.3

Source: INPUT

In the manufacturing sector, there is comparatively little desire, compared to other industry sectors, to retain any IT functions in-house. Furthermore, the relative level of satisfaction with the performance of in-house IT departments is very low. This is particularly true in terms of their ability to apply IT to the business, particularly their knowledge of business issues and their ability to apply this knowledge pro-actively.

The result is a shift in emphasis from transition outsourcing and the management of datacentres to entrusting vendors with responsibility for the re-application of IT to the business. Examples include FAG Kügelfischer's contract with IBM Systeme und Netze and CSC's contracts with British Aerospace and Lucas.

Retail and Process Manufacturing Sectors Adopt Client/Server Systems Management

Indeed the systems development capability of in-house IT departments remains a major cause for concern across a wide range of sectors.

Exhibit 2 identifies the gap between importance and satisfaction across a range of in-house IT functions.

The next major area of concern for managers, after new systems development, is their organisations' internal ability to support the emerging distributed systems environment in the form of wide area networks, local area networks and the desktop.

Exhibit 2

In-house Performance of IT Functions

IT Activity	Importance	Satisfaction	Difference
New system development	4.0	3.0	1.0
Provision and support for wide area connectivity	3.8	3.0	0.8
Application selection and integration	3.9	3.2	0.7
Day-to-day support of LANs/desktop environment	3.8	3.2	0.6
Support of branch locations	3.8	3.2	0.6
Maintenance of existing applications	3.6	3.6	0
Day-to-day operation of datacentres	3.5	3.6	(0.1)

Source: INPUT

While these concerns are again widespread, they are particularly evident in the retail, process manufacturing and banking sectors where organisations often have widely distributed branch networks.

The high level of geographic complexity within these organisations has so far been the major factor in their adoption of desktop services. However, this is an area where the leading vendors are now building up considerable remote management capability and the vendors' enhanced proficiency compared to typical in-house capability will lead to strong market growth over the next few years.

The driving forces are slightly different for wide area network outsourcing.

In particular, many corporate data networks are now completely out-of-date. They lack the throughput required to support interconnected LANs and new technologies such as multimedia. They are also implemented in inappropriate topologies for support of client/server infrastructures and in legacy technologies.

The situation is analogous to that in which mainframe systems found themselves five to ten years ago and which led to the downsizing and transition outsourcing movements. Accordingly, many organisations would ideally like to replace their existing networks with a more flexible, and appropriate form of network support.

However, unlike downsizing, few organisations now wish to retain ownership of their wide area networks. Ideally, organisations would like to transfer their existing wide area networks to an outsourcing vendor and in return purchase services based on more up-to-date technologies such as ATM.

For example, TSB and National Westminster bank have both entered into contracts with BT in the U.K. in an attempt to achieve such goals

Exhibit 3 summarises the extent to which individual modes of outsourcing are favoured by industry sector.

Exhibit 3

Key Opportunities by Industry Sector

Sector	Platform operations	Desktop services	Network management	Application management	Applications operations
Banking and Finance	Low	High	Medium - High	Medium - High	Low
Insurance	Low - Medium	Low - Medium	Low - Medium	High	High
Discrete manufacturing	Medium	Medium	Low - Medium	Medium	High
Process manufacturing	Medium	High	High	Medium	Medium - High
Retail distribution	Low - Medium	High	Medium - High	Medium - High	Medium - High
Wholesale distribution	High	High	Low - Medium	Low - Medium	Low - Medium
Transportation	Low - Medium	Medium - High	High	Low - Medium	High

Source: INPUT

UK Government Outsourcing Still Accelerating

Exhibit 4 provides a forecast of outsourcing sector growth by industry sector.

The relative size of the market in the government sector is all the more remarkable since there is little activity in this sector in either France or Germany.

However, in the U.K., the public sector is now the biggest user of outsourcing, and the outsourcing revenues from central government are now overtaking those from local government. Following the outsourcing of the IT Office of the Inland Revenue, a number of other major government departments have now outsourced IT functions, including, Department of Trade & Industry, the Home Office, and, in 1995, the Department of Social Security.

In spite of this high level of activity, government will remain a major growth area with the Public Finance Initiative producing major outsourcing opportunities for vendors in central government and the health service at least over the life of the present administration.

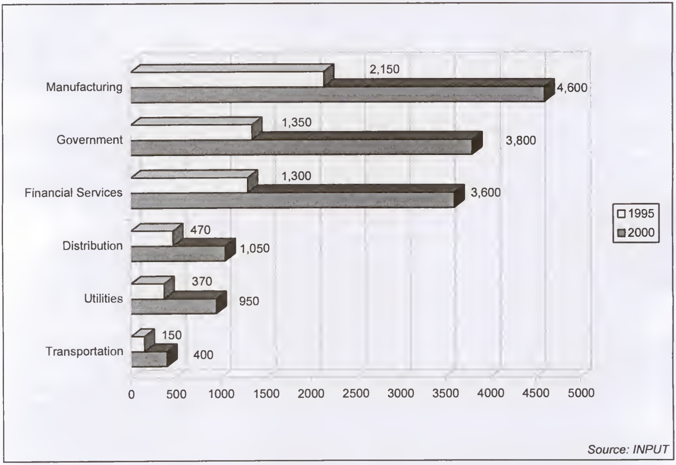
Indeed, the government has firmly placed the emphasis within the public sector on outsourcing contracts rather than systems integration projects with the launch of the Private Finance Initiative. The emphasis within this initiative is on substituting government funded projects with the supply of ongoing services, where the supplier invests the initial capital and shares the commercial risk in running the service with the public sector purchaser.

Any government department submitting a bid for funding for a major IT project to the Treasury is now likely to be requested to redraft its proposals so as to invite tenders for ongoing services within the framework of the Private Finance Initiative.

Similarly, the deadlines for Compulsory Competitive Tendering in local government will lead to major growth in this sector.

Exhibit 4

European Outsourcing Industry Sector Forecast



Source: INPUT

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Research Bulletin

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Public Finance Initiative Encourages Vendor Creativity

One of the most prevalent criticisms of the market testing process in U.K. central government was that market testing specifications tended to describe the method of current delivery rather than the nature of the output to be delivered. Consequently, the mechanism of market testing was perceived to discourage innovation by vendors.

However, market testing is now being superseded by a new concept: the Private Finance Initiative (PFI). PFI encourages vendors to adopt a much more innovative approach and encourages vendors to work more closely in partnership with their clients. In particular, it:

- Transfers responsibility for fitness for purpose to the vendor and endeavours to provide incentives for vendors to refresh the technology and solution adopted
- Encourages creative pricing
- Will lead to an increase in contract scope and length including an increase in business operations contracts.

Overall, there are currently approximately 50 PFI projects out to tender, and over 120 projects being considered. These projects range in value from $750K to $750m, with a total value of $2.5 billion.

Transfers Responsibility for Fitness for Purpose to the Vendor

The CCTA believe that the era of large scale market testing in U.K. central government is coming to a close and that there will be few major market testing exercises after the present group of tests involving, for example, the Health and Safety Executive and the NHS in Scotland.

In addition to its impact on market testing, contracts initiated within the Private Finance Initiative will tend to replace major systems integration projects in the public sector. The Treasury in the U.K. has stated that no new capital expenditure will be authorised unless the PFI route has been rigorously examined and shown to be inapplicable. Nor can existing departmental capital budgets be expected to remain intact.

Market testing was intended to improve value-for-money in purchasing services or projects on a like-for-like basis. However, the objectives of PFI are much wider and include:

- Obtaining value-for-money
- Transferring service risks to the private sector.

Central government procurement has traditionally relied on very detailed initial specifications to ensure fitness for purpose. However, these specifications have often had the opposite effect.

The PFI approach reverses this philosophy. The vendor is provided with only high level output specifications and is expected to take full responsibility for fitness for purpose.

Within PFI, vendors will be expected to fund the initial capital outlay and to recover their costs on the basis of a service charge for ongoing service provision. For example, in the first major PFI IT contract, under which Andersen Consulting has committed to develop the new National Insurance Recording System (NIRS 2) by April 1997, Andersen Consulting will receive no payments for systems development. The bulk of their revenues will be derived from the ongoing provision of a service based on this system.

This overcomes, from the government perspective, one of the key risks in undertaking major systems development projects, namely fitness for purpose. If the NIRS 2 system does not function adequately, then the government will bear neither the cost of enhancement nor the capital expenditure incurred in building a sub-standard system. These risks, which have historically been very substantial, are effectively transferred to the vendor.

The U.K. health sector, in particular, has experienced considerable difficulty in successfully applying information technology over the past decade. The PFI approach potentially enables Hospital Trusts to transfer the risk in achieving fitness for purpose to the private sector.

The first PFI project in the health service has already been contracted with Crawley and Horsham. Another 25 PFI projects in the health sector are under consideration, though only a small number of these involve IT. However, it is now mandatory that the PFI approach is tested for all capital expenditure requests within the NHS. At the moment, all capital requests from the NHS that do not evaluate a PFI-based solution are being declined by the Treasury, with a request that PFI be considered as an alternative approach. Only when PFI has been shown to be inapplicable to an individual case will alternative funding mechanisms be considered.

Although this has led to short term restrictions, the Private Finance Panel believes that this approach will ultimately increase the level of development in the NHS.

Encourages Creative Pricing Mechanisms

Within NIRS 2, the Private Finance Panel expects to achieve a 60% saving compared to the costs of building and running the system within the public sector. Typically, the Private Finance Panel expects to achieve 30-35% savings in the initial PFI contracts, settling down to 20-25% over time.

Through PFI, the government expects to achieve annual savings of approximately $3 billion per annum, approximately half of which will be re-invested in new contracts.

PFI adopts innovative pricing mechanisms and it also encourages creative pricing proposals from vendors.

PFI pricing can be based on three components:

- A service development component
- An operational service component
- A transfer payment.

In practice, the government prefers the vendor not to charge for system development but to recoup its costs on the basis of ongoing service charges. In those cases where the client does fund development activity, then the vendor is expected to provide a maximum price. In addition, a system of bonus payments will be used to provide incentives for the vendor to remain significantly below this ceiling.

The operational service provision will typically be priced on the basis of a volume related payment. Again, the vendor is expected to share some of the risk in the level of system usage.

For example, in the case of NIRS 2, service payments are based on 15 key transactions. However, the risk inherent in the actual volume of transactions are shared between vendor and client. In this case, payments based on a throughput of 70% of this volume are guaranteed to Andersen Consulting. However, the cost to the government is capped at approximately 125% of the estimated volume of transactions regardless of whether or not this level is exceeded.

Typically the Private Finance Panel expects to guarantee vendors 70% of the anticipated service payments, provided that the service is available and functioning appropriately.

In many instances, it will be difficult to establish the precise usage of a service in advance. In these cases, an overall price will be established and the service charge calibrated from this on the basis of usage in the first three months of service operation.

The final payment element is related to contract renewal. Four options are possible at contract renewal:

- The original vendor could win the renewal
- A new vendor could win the service contract using the systems developed by the original vendor
- A new vendor could win the service contract with a proposal based on new systems
- The administrative function that the service supports could have changed dramatically or be no longer required.

The option of a new vendor winning the contract whilst retaining the original vendor's systems is designed to prevent vendors from taking advantage of barriers to entry derived from their initial systems development and over-recovering their initial costs through service operation charges.

The Private Finance Panel believes that appropriate updating of service delivery technologies throughout the life of the contract will assist the vendor in ongoing service cost reduction resulting in lower charges to the government and improved margins for vendors. However, the government also wishes to incentivise vendors to refresh the technology and systems on which their service is based. These financial incentives are based on two elements:

- The first is a transfer payment to the original vendor, paid by the successful bidder, should they lose the contract renewal, but their solution remain the basis for the successful vendor's ongoing service provision
- The second is the absence of any transfer payment should a new vendor be successful with a new service proposal based on a new solution.

The size of the proposed transfer payment is dependent on the nature of the service being provided and its underlying technology. The transfer payment quoted is under the control of the vendor making the bid and the proportions quoted will vary considerably even within the same service opportunity.

So far, transfer payments of 10% and 25% have been quoted by vendors. At this stage, the Private Finance Panel expects transfer payments to typically fall in the range zero to 50%. The Private Finance Panel favours high transfer values, perceiving transfer values to be an expression of the vendor's confidence in their solution and their willingness to refresh applications and technology as necessary during the life of the contract.

In theory, transfer prices could be based on a combination of equipment, personnel and applications. However, in practice, the Private Finance Panel expects the application to account for the bulk of any transfer price. Any hardware is expected to be largely obsolete by the end of the contract, though periodic equipment refreshment could change this assumption.

Finally, should the application no longer be relevant because of, for example, legislative changes, then the government department will reimburse the vendor with the transfer payment.

The pricing mechanisms described above are a standard feature of PFI. In addition, the Private Finance Panel would like vendors to propose innovative risk sharing mechanisms of their own. In particular, the Private Finance Panel would like to see vendors developing revenue streams for their services from outside the public sector. For example, it is envisaged that a vendor developing and running systems for the public records office could base their total revenue recovery on selling services direct to non-governmental bodies. As a result, in this example, the government could meet its own aims at zero cost.

However, this approach means that successful vendors will need access to large amounts of capital, either internally or through collaboration with a financial institution, and must be able to sustain projects with a considerable negative cash flow in their early stages. Stage payments for development are not likely to be a successful approach in this new market.

The Private Finance Panel estimates that approximately five different pricing models for PFI are emerging. Details of these will be published in September.

The NIRS2 model is regarded as a relatively simple form of pricing where there is a need to provide the service quickly and where the volume of transactions can be accurately estimated in advance. Other models include one applicable to the NHS and a catalogue approach to supplying users with a range of application software products.

Leads to Increase in Business Operations Contracts

The philosophy adopted within PFI ensures that vendor creativity will be rewarded. It also encourages vendors to develop proposals that extend beyond IT. In the example suggested above, the most acceptable proposal for developing and running the IT systems within the public records office is likely to be one that involves the vendor taking responsibility for marketing the business operation and manning the customer interface not just providing IT services.

This trend towards business operations services has already become widely adopted within the U.K. local government community. It appears that much of the thinking behind the concept of the *enabling authority* is now being transferred beyond local authorities to other public sector bodies such as central government departments and the health sector.

For example, the PFI approach is now being considered for clerical functions within the Immigration Department, and it is probable that the entire DSS Occupational Pensions Regulatory Authority will be outsourced under PFI. This approach may also be adopted within the DSS Benefits Agency provided that demarcation lines between adjudication and clerical functions can be established to leave adjudication as the responsibility of civil servants.

So far, PFI has yet to be applied to local government, but it is likely that this approach will be increasingly applied here also. The result will be an increase in managed service outsourcing and a decline in purely IT-related outsourcing.

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Vendors Need to Address Perceived Shortfalls in Industry Knowledge

Overall the level of awareness among senior executives of the capabilities of individual outsourcing vendors is quite low. Nonetheless it is possible to examine the current perceptions of executives to obtain typical attitudes towards:

- Vendor capability relative to in-house IT departments
- Some of the perceived strengths and weaknesses of individual vendors.

Such an analysis reveals that:

- IT departments are still typically perceived to have much higher knowledge of their organisation's business sector than even the leading outsourcing vendors
- Vendors are perceived to possess superior ability to IT departments in the application of IT
- Systems vendors are perceived to have the most up-to-date technical skills.

Exhibit 1

Relative IT Department Capability

Characteristic	IT Department Rating	Average Rating of Leading Outsourcing Vendors	Difference
Reengineering Capability	3.1	3.4	0.3
Industry Sector Knowledge	3.6	3.0	(0.6)
Ability to Apply IT to the Business	3.0	3.6	0.6
Up-to-date Technical Skills	3.3	4.0	0.7
Cost Reduction Capability	3.1	3.4	0.3
Average	3.2	3.5	0.3

Source: INPUT

IT Departments Perceived to Have Greater Industry Knowledge Than Outsourcing Vendors

Exhibit 1 shows a comparison between the perceived capabilities of IT departments and three leading IT outsourcing vendors. The three vendors used for this analysis were Cap Gemini Sogeti, EDS, and IBM and the research was based on interviews in France, Germany and the UK. debis Systemhaus was regarded as part of Cap Gemini Sogeti for the purposes of this analysis, since the two organisations have a common approach and offerings in outsourcing.

The first conclusion from this research is that neither the outsourcing vendors nor IT departments are especially highly regarded. The successful application of IT remains a major problem for many organisations.

In the past, many senior executives have tended to regard the capabilities of vendors and IT departments as largely comparable. However, the leading outsourcing vendors are now beginning to differentiate themselves from IT departments.

Much of this differentiation is based, not on perceived superior commercial insight, but on superior technical and project management skills. Indeed, relevant industry sector knowledge is the characteristic where vendors receive their lowest rating from potential customers.

In order to address this weakness, many vendors are establishing industry sector based competence sectors and organising their sales approach on a sector specific basis. However, in spite of these approaches, it remains difficult for a vendor to maintain a detailed understanding of all the nuances within, for example, the manufacturing sector, where there is considerable heterogeneity of business practice. Many organisations still regard their business approach and processes as unique.

Vendors Perceived To Have Greater IT Application Skills

One way of avoiding some of the difficulties in developing detailed business knowledge across an extremely wide and heterogeneous range of industries, is to concentrate on a skill-based, rather than a knowledge-based, approach.

The leading vendors are beginning to establish a degree of credibility in terms of their reengineering capability. At the same time, vendors are perceived to be considerably in advance of IT departments in applying IT to business problems.

Accordingly, vendors should be prepared to leverage in-house industry knowledge, but stress their capability to add value by:

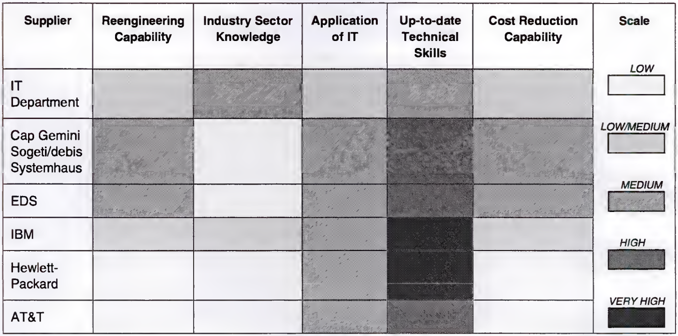
- Examining and modifying the organisation's current business processes
- Successfully applying IT to the new business processes.

Exhibit 2 compares the perceived strengths of a number of outsourcing suppliers against a number of key criteria.

It is taking time for the outsourcing vendors to establish their reengineering credentials. Outsourcing has typically been viewed as an important support process in reengineering projects, but a process whose contribution was indirect rather than making a strong direct contribution.

Exhibit 2

Perceived Supplier Capability: Europe



Supplier	Reengineering Capability	Industry Sector Knowledge	Application of IT	Up-to-date Technical Skills	Cost Reduction Capability
IT Department	LOW/MEDIUM	HIGH	LOW/MEDIUM	MEDIUM	LOW/MEDIUM
Cap Gemini Sogeti/debis Systemhaus	MEDIUM	LOW	MEDIUM	HIGH	MEDIUM
EDS	MEDIUM	LOW	MEDIUM	HIGH	MEDIUM
IBM	LOW/MEDIUM	LOW/MEDIUM	MEDIUM	VERY HIGH	LOW/MEDIUM
Hewlett-Packard	LOW	LOW	MEDIUM	VERY HIGH	LOW
AT&T	LOW	LOW	MEDIUM	HIGH	LOW

Source: INPUT

However, EDS and Cap Gemini Sogeti are now perceived to have a significantly higher level of reengineering capability than IT departments.

EDS is taking advantage of this perceived reengineering approach and has encapsulated it into its cosourcing offering. However, Cap Gemini Sogeti still appears to be having problems in leveraging the expertise of Gemini Consulting. Many of these problems appear to result from the separation of Gemini Consulting from Cap Gemini Sogeti and from the Cap Gemini Sogeti's desire to incrementally offer services such as distributed systems management and application management. Marketing these services as individual offerings makes it more difficult for Cap Gemini Sogeti to present itself as a company capable of delivering business transformation.

IBM is regarded as having a similar level of reengineering capability as IT departments, but the highest level of industry knowledge amongst the vendors listed.

However, one of the most significant perceived weaknesses of IT departments is their relative difficulty in successfully applying IT to business processes. All of the vendors listed were perceived to have greater capability than IT departments.

In conclusion, it may still be difficult for many vendors to demonstrate sufficient industry knowledge and reengineering capability to acquire major applications operations responsibility. However, vendors' relative strength in the application of IT combined with IT departments' current difficulties in new systems development potentially creates major application management opportunities.

Of those listed the two vendors perceived to have the highest level of ability to apply IT to the business were IBM and Cap Gemini Sogeti. Cap Gemini Sogeti and debis Systemhaus have been successful in developing and promoting application management as a separate service offering. Possibly it is time for IBM to take advantage of its comparatively strong image and also develop a focused application management offering across Europe.

Systems Vendors are Perceived to Have Most Up-to-date Technical Skills

In addition to the ability to apply IT to business problems, there was one other characteristic where all the vendors listed were perceived to be stronger than IT departments, namely in maintaining up-to-date technical skills.

This perception will be particularly important in influencing the award of infrastructure management contracts such as desktop services. Even though much of the technology involved is based around software product knowledge rather than hardware related expertise, the systems vendors namely Hewlett-Packard, IBM and AT&T are perceived to have higher levels of capability than Cap Gemini Sogeti and EDS.

Hewlett-Packard is regarded as having a very high level of expertise in client/server technology. The acquisition of Lotus should assist IBM in demonstrating a strong technological understanding of the desktop environment.

Cost reduction capability is another important factor in the infrastructure management area. However, despite the apparent price-competitiveness of Axone in France and IBM Système und Netze in Germany, IBM is perceived to have a lower level of cost reduction capability than Cap Gemini Sogeti and EDS.

The systems vendors need to complement their perceived high level of technical capability with an improvement in their perceived ability to reduce an organisation's IT costs.

This Research Bulletin is issued as part of INPUT's Outsourcing Programme — Europe. If you have any questions or comments on this bulletin please call your local INPUT organisation or John Willmott at INPUT, Cornwall House, 55-77 High Street, Slough, Berkshire, SL1 1DZ. Tel: +44(0)1753 530444.

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Research Bulletin

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Network Management Expenditure Forecast to Grow at 38% Per Annum

There is currently a very high level of demand for network management services in Europe. Recent research by INPUT indicated that a quarter of major organisations expect to outsource network management within three years.

Until now this high level of demand has not been matched in Europe by a similar level of supply capability. In particular it has been very difficult for any individual vendor to meet the geographic and technological requirements of potential clients.

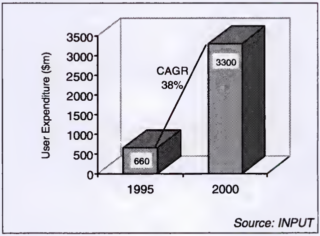
However, there are now signs that an increasing proportion of this pent-up demand is being realised. In particular:

- The early adopters will tend to be organisations with a concentrated geographic focus
- Merger activity will accelerate the development of vendor capability.

As a result of these developments, INPUT has increased the forecast growth rates for network management in Europe from 16% to 38% as shown in Exhibit 1.

Exhibit 1

Network Management Forecast, Europe



Source: INPUT

Early Adopters are in Financial Services

Exhibit 2 lists the user importance and satisfaction ratings for provision and support for wide area connectivity in Europe by sector.

Exhibit 2

Provision & Support for Wide Area Connectivity

Sector	Importance Rating (1-5)	Satisfaction Rating (1-5)	Difference
Process manufacturing	3.9	2.8	1.1
Discrete manufacturing	3.7	2.8	0.9
Transportation	4.4	3.5	0.9
Retail	3.6	3.0	0.6
Wholesale	3.3	2.8	0.5
Banking & Finance	3.8	3.3	0.5
Insurance	3.7	3.5	0.2

Source: INPUT

There is a significant gap between the importance and satisfaction levels for provision and support for wide area connectivity across each of the sectors listed, with the exception of the insurance sector. Accordingly there is a strong, widespread need for wide-area network outsourcing across sectors.

However, the prime motivations behind wide-area network outsourcing and the reasons for dissatisfaction within organisations vary by sector and these factors will have a major impact on the timing of WAN outsourcing decisions.

The data shown in Exhibit 2 indicates major manufacturing organisations have the greatest need for network outsourcing because of the comparatively low quality of existing services. However, manufacturing organisations typically have a strong need for widespread geographic coverage and, while they would like to improve their electronic access to key customers and suppliers, they are not typically especially innovative in their use of networking technology.

This need for widespread geographic coverage in the manufacturing sector is illustrated by the recent $150m contract between the aluminium producer Alcoa and Hewlett-Packard. Alcoa is creating a network to connect 15,000 users across 26 countries.

However, it is often difficult for vendors to cost-effectively support widespread international wide area networks at present. Accordingly the bulk of the initial activity in network outsourcing is forecast to be in sectors, such as financial services, that are primarily focused on national markets.

Organisations in the financial services sector typically wish to adopt new network technology to assist them in offering new types of service and improving service delivery.

Accordingly the main drivers for network outsourcing in the financial sector are primarily technological. For example, Sun Alliance has recently outsourced its wide area network management to BT. The new network being supplied by BT will connect approximately 80 sites in the U.K. and form the infrastructure around which Sun Alliance will market insurance services electronically to the domestic market. Within Sun Alliance, approximately 140 LANs will be linked by the new network. BT will replace Sun Alliances' existing leased line network with switched multi-megabit data services.

Exhibit 3

Network Management Contracts: Financial Services Sector

Client	Vendor	Contract Value ($m)	Contract Length (years)	Year Signed
NatWest Bank	BT	550	5	1995
Sun Alliance	BT	25	5	1995
Lombard North Central	BT	50	7	1994

Source: INPUT

Further recent examples of network outsourcing contracts in the financial services sector are shown in Exhibit 3.

NatWest Bank was driven to outsource its network to BT by the size of the investment required to introduce a new network in support of its new branch banking systems.

To satisfy the needs of the financial institutions, vendors need to improve their ability to deliver new technology. TSB, another major UK bank, outsourced one of its corporate data networks in 1992, with similar goals to those of NatWest, namely reducing cost and introducing new technology. So far, TSB has found that the vendor has tended to manage the existing X.25 network rather than migrate the bank onto ATM technology as originally hoped.

Other network management contracts outside the financial services sector are listed in Exhibit 4.

Exhibit 4

Network Management Contracts

Vendor	Clients
BT	BP Glaxo Thorn-Emi
France Télécom	Danzas Avis Europe
Racal	Heinz UK Probation Service

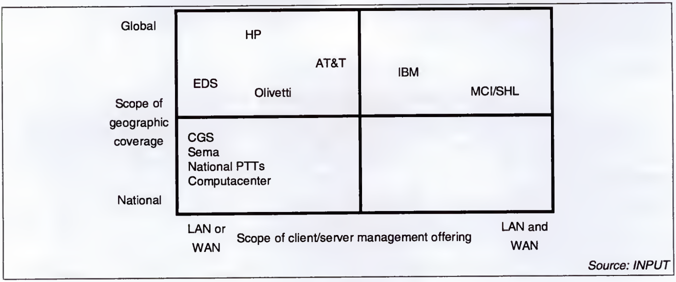
Source: INPUT

Mergers Lead to Enhanced Vendor Capability

Ideally many organisations do not wish to individually outsource the provision and management of their LAN and WAN networks. They would prefer to appoint a single vendor with combined LAN/WAN capability.

Exhibit 5

Client/Server Management Capability



Source: INPUT

However, it is currently difficult to find vendors with a combination of:

- LAN and WAN provision and support capability
- Wide geographic coverage.

Exhibit 5 lists INPUT's assessment of current vendor capability against these criteria.

However this competitive positioning is expected to change over the next few years as vendors undergo mergers with the aim of building more extensive client/server management capability.

The acquisition of SHL Systemhouse by MCI may be the first of a number of such mergers. While the merger of telecommunications equipment and computer equipment firms has historically shown low levels of success, there is apparently a very strong level of need for services organisations that can manage infrastructures based around the two technologies.

Updated Growth Forecast

The level of growth forecast for network management in the existing European outsourcing forecast anticipates slow growth between 1995 and 1998 as vendors build on their technological capability and geographic coverage.

However, as a result of the trends described above, these key inhibitors to growth in the network management market are beginning to decline and the forecast has been amended to take into account the following factors:

- Faster adoption of network outsourcing by organisations operating within primarily national boundaries e.g. financial institutions and government agencies
- Faster development of vendor capability.

The resulting forecast is shown in Exhibit 1.

This forecast is based on the following assumptions:

- 25% of primarily national organisations will adopt network outsourcing by the year 2000
- 8% of primarily multinational organisations will adopt network outsourcing by the year 2000.

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- Product/service opportunities
- Customer satisfaction levels
- Competitive positioning
- Acquisition targets

For Buyers–evaluate:

- Specific vendor capabilities
- Outsourcing options
- Systems plans
- Peer position

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1995

Financial Services Sector Adopts Increasing Core Business Focus

Historically within Europe, the financial services sector, both banking and finance and insurance, has tended to lag behind the manufacturing sector in the adoption of IT outsourcing.

The reasons for this situation include:

- The financial services sector's traditional preference for performing all business functions in-house and the low level of experience of outsourcing in the sector
- The view that IT is a vital part of service delivery and a potential source of competitive advantage.

However, there are now signs that there has been a significant increase in core business focus by management in the financial services sector in Europe during 1995, exemplified by:

- A significant increase in IT outsourcing and processing service activity
- The break-up of Centre-file in the UK.

Major Increase in IT Outsourcing Activity

Organisations within the banking and finance sector have significantly increased their use of outsourcing in 1995. However, with the notable exception of the contract between the Swiss Bank Corporation and Perot Systems, banking and finance organisations have tended to favour selective outsourcing.

Prior to 1995, many banking and finance organisations had already outsourced desktop services. Computacenter has been particularly successful in this sector in the UK winning contracts with:

- TSB
- Lehmann Brothers
- Morgan Stanley
- UBS
- Westpac.

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Exhibit 1

Processing Services Contracts: Financial Services Sector

Client	Vendor	Contract Type	Year Signed
Girobank	EDS	Merchant acquiring services	1995
Royal Bank of Scotland	EDS	Cheque processing	1995

Source: INPUT

Similarly a number of financial institutions had commenced application management contracts with outsourcing vendors. For example, FI Group has contracts with:

- Co-operative Bank
- Barclaycard.

However the major banks had typically been reluctant to outsource their mainframe datacentres. There are now signs that this is changing dramatically. The TSB in the UK has already outsourced its datacentres to Sema Group and the NatWest appears on the point of outsourcing its mainframes.

There has also been a significant UK increase during 1995 in the use of external vendors for processing services such as cheque and credit card processing. Such activities are already well-established in France through for example Axime.

Examples of contracts awarded in these areas during 1995 are listed in Exhibit 1.

Prior to 1995, EDS had a contract with Midland Bank for credit and debit card processing signed in 1990.

Cheque processing is now rightly regarded by the banking sector as a legacy activity. This makes it an ideal activity for outsourcing. By outsourcing cheque processing, financial institutions no longer have to concern themselves with high levels of investment and fixed cost which would lead to increasing costs per transaction as volumes decrease.

Exhibit 2

Network Management Contracts: Financial Services Sector

Client	Vendor	Contract Value ($m)	Contract Length (years)	Year Signed
NatWest Bank	BT	550	5	1995
Sun Alliance	BT	25	5	1995
Lombard North Central	BT	50	7	1994

Source: INPUT

The other area of recent substantial activity has been the outsourcing of wide area networks. Some examples of recent contracts are listed in Exhibit 2.

The outsourcing of wide area networks with particular reference to the financial services sector is discussed in Research Bulletin no. 9.

The insurance subsector has a similar level of need as the banking subsector for wide area networking outsourcing. Existing infrastructures are frequently inappropriate for image transmission between workgroups and in the medium-term electronic communication with domestic clients could replace even the current direct sales methods which rely primarily on voice-based communication.

Up-to-date, flexible, high-bandwidth communications will be one of the key success factors in the insurance sector of the future.

So far, the insurance sector has tended to adopt selective outsourcing contracts in a similar manner to the banking and finance sector.

For example, application management contracts in the insurance sector include:

- NatWest Life's contract with Hoskyns
- FI Group's contract with Britannia Life.

However, at present there is greater business pressure on insurance companies than organisations in the banking and finance sector. As a result, contracts have arisen whose purpose is to enable organisations that have decided to exit the life assurance market to run down their operations.

Examples of contracts that assist insurance companies in running down their involvement in life assurance include:

- Hoskyns' contract with Hill Samuel
- Unisys' contract with Target Life.

Secondly as a result of the considerable business pressures on insurance companies, such organisations are likely to adopt full applications operations outsourcing.

Examples of full applications operations outsourcing in the insurance sector include:

- EDS' contract with INA in Italy
- IBM Systéme und Netze's contract with Gothaer Versicherungen AG.

In addition, IBM ISSC and Andersen Consulting have a major global outsourcing contract with Marsh & McLennan.

Break-up of Centre-file

Many major organisations have endeavoured to ensure that their in-house IT service providers remain up-to-date and competitive by establishing them as separate trading subsidiaries.

In the financial services sector there are many organisations that have been established either in this way, for example Centre-file (parent NatWest) and BCO (parent Barclays) or as co-operatives serving a number of financial institutions.

In some cases, the resulting entities have had considerable difficulty in expanding beyond serving members of the same group.

However, regardless of the degree of success of such subsidiaries, a number of organisations are now severing the links between parent and IT services subsidiary, enabling both parties a greater focus on their core activity.

For example ITnet has recently been subject to a management buy-out from Cadbury Schweppes, and CMS is believed to be in the process of being sold by British Steel.

This process frequently creates opportunities for the leading outsourcing vendors, for example EDS' acquisition of Lucas Management Systems.

As part of a greater core business focus and cost reduction programme, Nat West is now selling off the divisions of Centre-file. Initially NatWest is selling the Personnel and Payroll Services division of Centre-file to Ceridian Corporation. Divestments of other subsidiaries will follow.

It also seems probable that NatWest will outsource IT services that are not provided by Centre-file. In particular, it seems likely that NatWest will soon outsource its data centres.

This may be the start of a trend with significant implications for IT services subsidiaries and co-operatives in the financial services sector throughout Europe.

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Research Bulletin

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What is Outsourcing?

Although the term *outsourcing* has been widely used in Europe for some years, there is still a lack of clarity associated with it. In particular, the distinction between outsourcing and processing services remains an area of confusion.

To clarify INPUT's position on terminology, this bulletin:

- Explains INPUT's definitions
- Considers the use of related terminology in Europe
- Examines the impact on vendor rankings of combining vendors' outsourcing and processing services revenues.

Clarification of Definitions

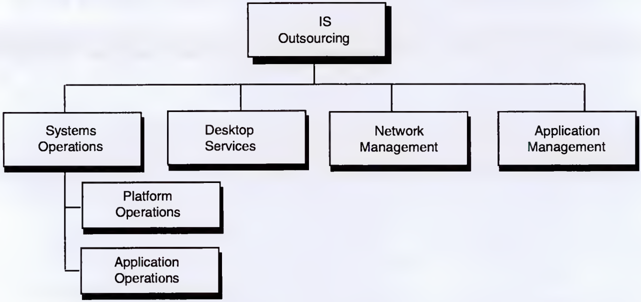
As defined by INPUT, outsourcing is a long-term relationship (greater than one year) between a client and vendor in which the client delegates all, or a major portion, of an operation or function to the vendor. The operation or function may be solely Information Systems Outsourcing-based, or merely include Information Systems Outsourcing as a prominent component of the operation (at least 30% of the budget).

The critical components defining an outsourcing service are:

- Delegating an identifiable area of the operation to a vendor
- Single vendor responsibility for performing that delegated function
- Intended, long-term relationship between the client and vendor
- Contract term is at least one year
- Client's intent is not to perform this function with internal resources
- The contract may include non-Information Systems Outsourcing activities, but Information Systems Outsourcing must be an integral part of the contract
- Outsourcing is a collection of services integrated under a single, long-term contract with one vendor responsible for its operation and management.

Exhibit 1

Information Systems (IS) Outsourcing Service Categories



Source: INPUT

Business Operations Outsourcing (also known as, Business Outsourcing or Functional Outsourcing) is a relationship in which one vendor is responsible for performing an entire business/operations function including the Information Systems Outsourcing that support it. The Information Systems Outsourcing content of such a contract must be at least 30% of the total annual expenditure in order for INPUT to include it in the Business Operations Outsourcing market.

Information Systems (IS) Outsourcing can be viewed as a component of the Business Operations Outsourcing market. However, in order to delineate between outsourcing contracts that are solely IS versus those that include IS as well as other functions, IS Outsourcing is segregated from Business Operations Outsourcing. Information systems Outsourcing is divided into four service components as shown in Exhibit 1.

- *Systems Operations* outsourcing describes a relationship in which a vendor is responsible for managing and operating a client's computer system/data centre (*Platform Systems Operations*) or developing and/or maintaining a client's applications as well as performing Platform Operations for those applications (Applications Systems Operations).

- *Desktop Services* is a relationship in which a vendor assumes responsibility for the deployment, maintenance and connectivity of personal computer, workstations, client/server and LAN systems in the client organisation. To be considered as Desktop Services outsourcing, a contract must include a significant number of the individual services listed below:

  - Software Product Supply
  - Equipment Supply
  - Equipment/Software Installation
  - Equipment Maintenance
  - LAN Installation and Expansion
  - LAN Management
  - Network Interface Management
  - Client/Server Support
  - Logistics Management
  - User Support
  - Help Desk Functions
  - User Training and Education.

- *Network Management* outsourcing is a relationship in which a vendor assumes full responsibility for operating and managing the client's data telecommunications systems. This may also include the voice, image and video telecommunications components.

- *Application Management* is a relationship in which the vendor has full responsibility for developing and maintaining all of the application or function.

The above definitions focus on the services covered in the outsourcing contract. For example, an Application Operations contract can include all facets of Information Systems Outsourcing (platform operations, desktop services, network and application management). The key to INPUT's market definition is the service contract . If a customer only wants to outsource the network, it is network management outsourcing. If an airline, for example, wishes to outsource their reservation operation which includes not only the network, but also its infrastructure, applications and the people running the operation, this is a Business Operations Outsourcing contract.

What is not included in INPUT's world of outsourcing are the following:

- Project based services are not considered as part of outsourcing. Thus, Systems Integration and application development projects are not included

- Services that were never intended to be performed internally. Maintenance only services do not constitute an outsourcing function by itself. however, responsibility for hardware and software maintenance is inherent in most outsourcing contracts

- Processing services contracts

- Voice-only network management

- Business operations with minimal information systems content. The outsourcing of the marketing communication function to an outside agency is not covered by INPUT's analysis. A function or business operation must at least have 30% of its budget attributed to information technology to be included.

One of the areas of potentially highest confusion is between outsourcing and processing services.

Processing services come in three types:

- Transaction Processing - Client uses vendor provided information systems including hardware, software and/or data networks – at the vendor or customer site to process **specific applications** and update client data bases. The application software is typically provided by the vendor. Examples of this type of processing service are payroll services, cheque processing, and SAP R/2 processing

- Utility Processing – Vendor provides basic software tools enabling clients to develop and/or operate their own programs or process data on the vendor's system
- Other processing services – Vendor provides service – usually at the vendor site - such as scanning and other data entry services, laser printing, computer output microfilm (COM), CD preparation and other data output services, backup and disaster recovery, etc.

As vendors build on their transaction processing services by adding clerical functions so the nature of services such as payroll and share registration services will migrate from the processing services category to business operations.

National Definitions of Outsourcing

In the UK there is no clear agreement on definitions. In the past, the term FM was widely used. However, vendors are now phasing out the term FM in favour of outsourcing.

The CSSA in the UK defines outsourcing as: *The delegation to a third party of the continuous management responsibility for the provision of an IT service under a contract that includes a service level agreement.*

IT services include: systems and technical strategy, business analysis, systems analysis and design, applications development, implementation and maintenance, network design and implementation, data centre and/or network operations, technical support/systems programming, desktop and helpdesk support.

The CSSA perceives that facilities management (FM) has come to represent the management of part or all of the data centre resources, and accordingly is a subset of IT outsourcing.

Amongst users the term outsourcing has no clear meaning and is still widely used to mean any form of subcontracting.

In France, the following terms are used:

- FM d'Exploitation is concerned with data centre management and corresponds to INPUT's platform operations category
- Gestion d'applications which corresponds to INPUT's definition of application management
- FM de Réseaux which translates into network management but includes local area and/or wide area networks. INPUT's definition of network outsourcing is restricted to wide area network outsourcing
- FM Micro corresponds to desktop services in INPUT's outsourcing definitions
- FM de Transition (transition management) is the type of outsourcing where a client is using a vendor to phase out legacy equipment (typically mainframes) and applications. Within INPUT's definitions, it is included in the applications operations category
- FM Global is full service outsourcing such as is included in INPUT's applications operations category.

In Germany, the term SAP outsourcing has been used for some time. SAP R/2 outsourcing in terms of INPUT's definitions is a processing service.

Impact on Vendor Rankings

In France the main area of confusion between outsourcing and processing services is in the area of transaction processing services, particularly in the banking sector.

Exhibits 1 and 2 list the leading outsourcing vendors in France and the leading vendors when outsourcing and processing services revenues are combined.

Exhibit 1

Leading Outsourcing Vendors France, 1994

Vendor	Estimated 1994 Outsourcing Revenues (FFm)	Estimated Market Share (%)
EDS	1000	17
Télésystèmes	620	11
Cap Gemini Sogeti	560	10
Axone	550	9
GSI	400	7
Integris	400	7
SG2	230	4
Perot Systems	200	3
France Telecom	200	3
Axime	185	3
Sligos	175	3
Total Market	5800	100

Source: INPUT

Exhibit 2

Leading Vendors: Outsourcing & Processing Services France, 1994

Vendor	Outsourcing & Processing Services(FFm)	Estimated Market Share (%)
EDS	1145	8
Axime	1075	7
Télésystèmes	1000	7
Sligos	960	7
GSI	710	5
Cap Gemini Sogeti	560	4
Axone	550	4
Integris	400	3
SG2	400	3
Perot Systems	200	1
France Telecom	200	1
Total Market	14700	100

Source: INPUT

In France, combining revenues for outsourcing and processing services has a considerable impact on the rankings of Axime and Sligos, which are now ranked 2nd and 4th respectively.

Both vendors have extensive processing services activity in the banking sector. Within its means of payment processing service, Axime processed 350 million bank card transactions in 1994.

Exhibits 3 and 4 list the leading outsourcing vendors in Germany and the leading vendors when outsourcing and processing services revenues are combined.

Exhibit 3

Leading Outsourcing Vendors
Germany, 1994

Vendor	Estimated 1994 Outsourcing Revenues (DMm)	Estimated Market Share (%)
IBM Systeme und Netze	230	18
EDS	200	16
debis Systemhaus	180	14
tds	88	7
Alldata	82	7
Sema Group	75	6
Siemens-Nixdorf	50	4
Digital	45	4
AC Service	40	3
CSC	30	2
Total Market	1250	100

Source: INPUT

Exhibit 4

Leading Vendors: Outsourcing & Processing Services
Germany, 1994

Vendor	Outsourcing & Processing Services(DMm)	Estimated Market Share (%)
Datev	685	18
debis Systemhaus	320	8
IBM ISSC	315	8
EDS	200	5
Fiducia	145	4
Alldata	127	3
tds	88	2
Sema Group	75	2
RRZ	60	2
Sligos	60	2
Siemens-Nixdorf	50	1
Total Market	3850	100

Source: INPUT

In Germany, the principal beneficiaries of combining revenues for outsourcing and processing services are Datev and Fiducia.

INPUT's outsourcing vendor rankings in Germany already include vendors' SAP outsourcing activity. As the nature of SAP outsourcing changes from R/2 outsourcing to R/3 outsourcing, so the service provided will migrate from a mainframe-based transaction processing service to desktop services or applications operations outsourcing.

Exhibits 5 and 6 list the leading outsourcing vendors in the UK and the leading vendors when outsourcing and processing services revenues are combined.

Exhibit 5

Leading Outsourcing Vendors United Kingdom, 1994

Vendor	Estimated 1994 Outsourcing Revenues (£m)	Estimated Market Share (%)
Hoskyns	125	12
EDS	120	12
ICL/CFM	101	10
Sema Group	90	9
CSC	70	7
Andersen Consulting	65	6
Data Sciences	63	6
AT&T Istel	60	6
Capita Group	45	4
Digital	45	4
FI Group	40	4
Total Market	1020	100

Source: INPUT

Exhibit 6

Leading Vendors: Outsourcing & Processing Services United Kingdom, 1994

Vendor	Outsourcing & Processing Services(£m)	Estimated Market Share (%)
EDS	140	9
Cap Gemini Sogeti	125	8
ICL/CFM	101	6
Sema Group	90	6
CSC	90	6
Data Sciences	73	5
Andersen Consulting	65	4
AT&T Istel	60	4
Capita Group	45	3
Digital	45	3
FI Group	40	3
Total Market	1590	100

Source: INPUT

In the UK, combining revenues for outsourcing and processing services has little impact on vendor rankings.

Exhibits 7 and 8 list the leading outsourcing vendors in Italy and the leading vendors when outsourcing and processing services revenues are combined.

Exhibit 7

Leading Outsourcing Vendors
Italy, 1994

Vendor	Estimated 1994 Outsourcing Revenues (LBn)	Estimated Market Share (%)
Finsiel	140	27
Olivetti	80	15
IBM ISSC	25	5
Cap Gemini Sogeti	20	4
Integris	15	3
Total Market	520	100

Source: INPUT

In Italy, combining revenues for outsourcing and processing services emphasises the strength of the local vendors. However many of these vendors will be overtaken in the rankings by the major outsourcing vendors such as EDS and IBM ISSC as the latter begin to win major outsourcing contracts such as EDS' contract with The insurance group INA.

It is also likely that a number of the local processing services companies will be acquired by the major international outsourcing vendors over the next few years.

Exhibit 8

Leading Vendors: Outsourcing & Processing Services
Italy, 1994

Vendor	Outsourcing & Processing Services(LBn)	Estimated Market Share (%)
Finsiel	255	15
Olivetti	115	7
CED Borsa	115	7
Lombardia Informatica	80	5
Sopin	50	3
Sarin	42	3
IBM ISSC	40	2
Cap Gemini Sogeti	20	1
Integris	15	1
Digital	15	1
Total Market	1670	100

Source: INPUT

Exhibits 9 and 10 list the leading outsourcing vendors in Europe and the leading vendors when outsourcing and processing services revenues are combined.

Exhibit 9

Leading Outsourcing Vendors Europe, 1994

Vendor	Estimated 1994 Outsourcing Revenues ($m)	Estimated Market Share (%)
EDS	650	13
Cap Gemini Sogeti	570	12
IBM ISSC	340	7
Sema Group	275	6
CSC	180	4
ICL/CFM	160	3
Digital	160	3
Integris	140	3
Télésystèmes	120	2
Andersen Consulting	120	2
GSI	95	2
Total Market	4950	100

Source: INPUT

Exhibit 10

Leading Vendors: Outsourcing & Processing Services Europe, 1994

Vendor	Outsourcing & Processing Services($m)	Estimated Market Share (%)
EDS	710	5
Cap Gemini Sogeti	670	5
IBM ISSC	450	3
Datev	440	3
Sema Group	275	2
CSC	265	2
Sligos	205	2
Télésystèmes	190	1
GSI	190	1
Axime	180	1
ICL/CFM	160	1
Total Market	13200	100

Source: INPUT

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Research Bulletin

A Publication from INPUT's Outsourcing Programme - Europe

Vol. VII, No. 4

1996

Outsourcing Vendors Achieve Net Margins of Seven Per Cent

Much of the industry focus within the outsourcing sector at present is on the delivery of business value. Simultaneously some vendors are attempting to reduce their clients' focus on cost reduction.

However, in practice, clients require vendors to deliver both business value and excellent value for money. Most organisations still strongly associate outsourcing with cost reduction and the outsourcing market has always been notable for margin pressure on vendors.

Exhibit 1 lists the average margins and revenues per head achieved by service type.

Influenced by these margins and clients' expectations of continuing cost reduction:

- The number of vendors offering datacentre management services will continue to decline
- The shake-out in distributed systems management is imminent
- Application management margins will decline
- Vendors will seek to protect their margins by delivering increased business value.

Exhibit 1

Outsourcing Margins by Service Type

Service Type	Gross Margin (%)	Net Margin (%)	Revenue per head ($000s)
Datacentre management	14	6	125
Distributed systems management	19	7	255
Application management	24	13	205
All outsourcing	17	7	*130

Source: INPUT

Note: ** Sales and administrative personnel are typically not fully allocated by service line. Hence the overall revenue per head appears low compared to the service line figures. On a like for like basis, removing non-operational personnel, the figure becomes 155.*

The financial data in this bulletin is based on data from a sample of seven leading outsourcing vendors. INPUT would like to express its thanks to these organisations for providing this data in confidence.

The Number Of Vendors Offering Datacentre Management Services Will Continue To Decline

Vendor profit margins continue to be lowest in this segment. Overall the range of net margins in mainframe datacentre management achieved by vendors is quite narrow with the majority of vendors having net margins in the range 4%-6%.

Vendor pricing in datacentre management services is strongly influenced by market presence and economies of scale.

For example, it is noticeable that IBM is currently placing some other outsourcing vendors under considerable price pressure in Germany. Similarly, Axone has, in the past, adopted a similar stance in France.

Pressures such as these, together with high user expectations of cost reduction in this area, will lead to a continuing vendor exodus from platform operations. The impact will continue to be greatest on national vendors, lacking the financial resources of their multinational rivals.

One notable recent example was Data Sciences' decision in 1995 to sell its mainframe-based platform operations activities to Integris/Bull.

The company was one of the early leaders in the U.K. platform operations market, but in 1995 decided to focus on the perceived higher value activities of distributed systems management and, in particular, application management.

In the same year, CMS was sold by British Steel to Hoskyns, perhaps partly in recognition of the level of price competition in platform operations.

This trend will undoubtedly continue. It is currently unlikely that more than six vendors are truly price competitive in mainframe datacentre management in any country in Europe.

Exhibit 2 shows the range of prices per MIP currently charged for mainframe operations.

Exhibit 2

Mainframe Pricing

	Price per MIP $(000s)
Lowest price	15
Highest price	60
Average price	25

Source: INPUT

The lowest price charged per MIP still varies considerably (by a factor of 2) between vendors, though it appears that the higher prices may be used largely for captive clients that are part of the same group of companies as the vendor organisation.

Similarly, the width of the price band varies considerably between vendors. In some instances, the price band is narrow. For example, in one instance, the highest price is an increase of only 30% on the lowest price. More typically, the price band is wider, with a factor of three to four between the highest and lowest rates charged.

The Shake-Out In Distributed Systems Management Is Imminent

Nowadays, margins are also under pressure in distributed systems management and, in particular, desktop services.

Already average net margins in these areas are only slightly higher than for mainframe datacentre management.

However there is a much greater range of net margin between vendors, with vendors reporting net margins between (5)% and +15%.

This reflects the current wide variation in pricing and delivery mechanisms used. For example, prospects for desktop services report being discouraged by the wide variation in price quoted to them by vendors. At the same time, vendors are still implementing the network management centres that will enable them to increase the proportion of network and desktop management performed remotely and, in many cases, more cost-effectively.

At present, only a very small proportion of desktop services activity is carried out in this way. As a result, some desktop services clients are currently dissatisfied with the value for money that they receive.

Once these support infrastructures are in place and stable and vendors have managed to stabilise their clients' desktop infrastructures, then desktop support costs can be dramatically reduced.

This will lead to considerably increased price competition in desktop services in a similar manner to that which occurred in mainframe datacentre management several years ago.

Already some vendors, for example Cap Sesa Hoskyns, recognise that it will be difficult for them to compete in commodity desktop services outsourcing and are focusing on more specialised niches within distributed systems management.

Application Management Margins Will Decline

Net margins are currently highest within application management.

However, it is probable that application management pricing will decrease over the next twelve months, with an accompanying impact on vendor margins.

Firstly, application management has until recently been a relatively specialist area offered by considerably fewer vendors than offer either datacentre management or, indeed, desktop services.

However, this is now beginning to change with a wider range of vendors, for example Data Sciences and Logica, belatedly recognising the market potential. Indeed, the European application management market is also being viewed as an opportunity by U.S.-based specialists such as Computer Horizons, who are looking for partners in the U.K.

Secondly, clients of application management services are not particularly satisfied with the levels of cost control achieved so far.

These trends will lead to an increased emphasis on the use of tools and offshore outsourcing to achieve more competitive pricing in this area.

Vendors Will Seek To Protect Their Margins By Delivering Increased Business Value

An important question for outsourcing vendors is how to protect their margins from extremes of price competition.

Part of the answer lies in maintaining competitive operational cost structures. However the service style of the vendor is also important.

Exhibit 3 compares the profile of client outsourcing satisfaction ratings with the profile of clients' renewal intentions.

There is a significant gap between the two indicating that the cost-effective provision of contracted operational services to a high standard is not sufficient to guarantee client loyalty.

Indeed it is evident that clients do not exhibit high loyalty to vendors that rely largely on their strong price competitiveness. In these instances, clients will re-tender vigorously at the end of contracts to ensure that they are still achieving the best terms available.

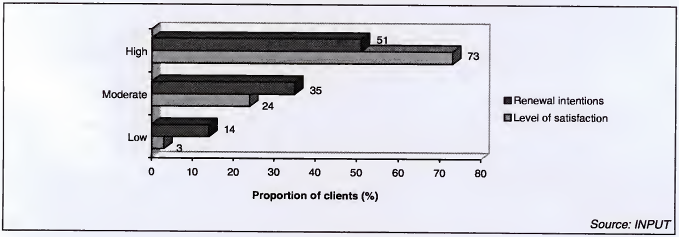
While value for money remains important, the other condition necessary to achieve a high level of client loyalty, and hence some margin protection, is the demonstration of greater value added through:

- The business contribution made by the vendor
- Performing as an agent of change
- The vendor's flexibility in adapting itself to changing client circumstances and needs.

These factors can be demonstrated by regression analysis to have a stronger correlation with client renewal intentions than service quality and cost-effectiveness.

Exhibit 3

The Gap Between Satisfaction and Contract Renewal



Source: INPUT

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Research Bulletin

A Publication from INPUT's Outsourcing Programme - Europe

Vol. VII, No. 5 1996

Only 14% of Desktop Outsourcing Market is Open to Niche Services Vendors

Two difficult, but vital, questions for executives purchasing outsourcing services are:

- Which services should be outsourced?
- In what combinations should they be outsourced?

In practice, these questions have to be answered on the basis of a unique understanding of the organisation concerned. However, there are some themes emerging by industry sector. In particular:

- Utilities have a strong focus on application management outsourcing
- Government bodies tend to outsource a full range of services
- Organisations in the financial services sector tend to adopt a highly selective approach to outsourcing.

The bundling patterns adopted by organisations are important in determining niche vendors' ability to access their markets. At present, bundling patterns are severely limiting market access by specialist desktop services vendors. On the basis of current contracts, these specialists have access to only 14% of the desktop services outsourcing market, suggesting a strong need for partnerships with other outsourcing service providers.

Utilities Have A Strong Focus On Application Management Outsourcing

Exhibit 1 lists the profile of services outsourced by organisations adopting outsourcing in recent years. It is based on a sample of 130 existing outsourcing contracts.

Exhibit 1

Outsourcing Service Profile by Industry

Sector	Datacentre management	Desktop Services	WAN Management	Application Maintenance Management	Application Development Management
Discrete Manufacturing	100	40	60	30	25
Process manufacturing	70	50	80	50	50
Utilities	45	45	35	80	55
Government	85	55	55	65	45
Financial Services	60	15	50	50	15
Business Services	75	10	20	40	30
All sectors	80	40	50	55	35

Source: INPUT

Note: This exhibit shows the proportion (%) of organisations already outsourcing that outsource each IT function.

There is a marked variation by sector. For example:

- The discrete manufacturing sector has a high concentration of datacentre management and a low propensity to outsource application management
- The process manufacturing sector has a high propensity to outsource distributed systems management with a focus on both WAN management and desktop services
- Utilities have shown a high propensity to outsource both application maintenance management and new systems development
- Organisations in the financial services sector have so far shown a low propensity to outsource desktop services and new systems development.

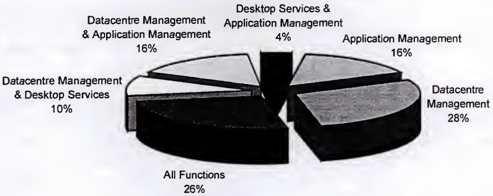
Government Bodies Tend To Outsource A Full Range Of Services

Exhibit 2 profiles the pattern of services outsourced by these organisations and Exhibit 3 profiles the pattern of services outsourced by industry sector.

These exhibits indicate the range of functions outsourced from the perspective of client organisations. However this is not a reflection of the manner, or timing, in which services are bundled together to present opportunities from the vendor perspective.

Exhibit 2

Outsourcing Service Combinations



Sample of 130 Outsourcing clients

Source: INPUT

Exhibit 3

Outsourcing Service Combinations by Industry

Sector	All functions	Datacentre Management & Desktop Services	Datacentre Management & Application Management	Desktop Services & Application Management	Desktop Services only	Application Management only	Datacentre Management only
Discrete Manufacturing	29	12	0	0	0	0	59
Process manufacturing	30	10	10	10	0	20	20
Utilities	30	10	10	10	0	40	0
Government	48	5	11	2	0	9	25
Financial Services	0	14	24	5	0	29	29
Business Services	0	13	27	7	0	13	40
Distribution	0	20	60	0	0	20	0

Source: INPUT

Note: This exhibit shows the proportion (%) of organisations already outsourcing that outsource each combination of IT functions.

Only a quarter of organisations already outsource datacentre management, desktop services and application management. For the purposes of this analysis, application management has been included if either application maintenance management or application development management has been outsourced.

No organisations were identified that currently outsourced desktop services but no other IT function. In past surveys by INPUT, many organisations have been found to outsource desktop services either in combination with datacentre operations or as a second stage in outsourcing, following on from datacentre operations. This appears to still largely apply.

Government organisations, including central government, local government and healthcare, have a relatively high propensity to outsource a wide range of IT functions, making them a natural target for full-service outsourcing vendors.

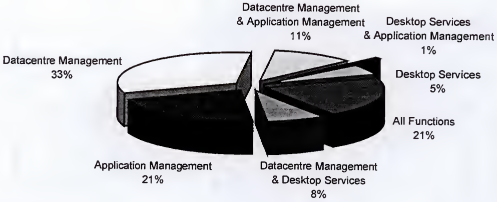
Organisations In The Financial Services Sector Tend To Adopt A Highly Selective Approach To Outsourcing

However, organisations that are outsourcing a wide range of functions may still decide to outsource to multiple best of breed vendors rather than a single full-service vendor. Exhibits 4 & 5 indicate the profile of outsourcing contracts that emerge from the vendor perspective once bundling is taken into account.

Exhibit 4 shows the overall profile of contract types that are currently outsourced to vendors. Exhibit 5 indicates the contract profile by industry sector.

Exhibit 4

Outsourcing Contract Profile



Sample of 130 Outsourcing clients

Source: INPUT

Exhibit 5

Outsourcing Contract Profile by Industry

Sector	All functions	Datacentre Management & Desktop Services	Datacentre Management & Application Management	Desktop Services & Application Management	Desktop Services	Application Management	Datacentre Management
Discrete Manufacturing	28	6	0	0	6	0	61
Process manufacturing	17	17	8	0	8	33	17
Utilities	15	0	8	8	15	38	15
Government	44	7	11	2	0	11	24
Financial Services	0	13	13	0	4	38	33
Business Services	0	6	17	0	11	22	44
Distribution	0	17	33	0	0	33	17

Source: INPUT

The highest level of service bundling is in the Government sector and the lowest in financial and business services.

The sectors that have so far been most inclined to outsource stand-alone desktop services are the utilities and business services sectors.

The sectors that have so far been most inclined to outsource stand-alone application management services are the utilities and financial services sectors.

Specialist Vendors Need to Develop Partnerships

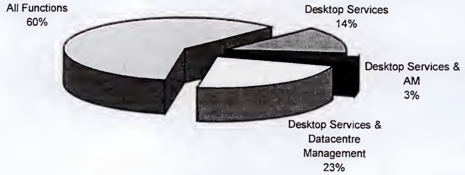
The current level of service bundling potentially restricts the market access of specialist vendors of desktop services and application management.

In particular, desktop services have historically been highly bundled in full-service contracts or incorporated into datacentre management contracts.

Exhibit 6 shows the profile of contracts containing desktop services outsourcing.

Exhibit 6

Accessibility of Desktop Services Market



Sample of 55 Outsourcing clients

Source: INPUT

Historically, only 14% of the desktop services market has been accessible to dedicated desktop services suppliers.

In the near future, INPUT expects the following trends in service bundling:

- A continuation of full service bundling amongst multinationals, particularly in the government and discrete manufacturing sectors
- Some unbundling of services at contract renewal, particularly in medium-sized contracts
- Increased outsourcing of client/server infrastructure management in the form of WAN management combined with desktop services outsourcing
- Increased stand-alone desktop services activity in the financial services sector
- A reduction in the level of stand-alone datacentre management outsourcing
- A greater emphasis on application development leading to higher levels of stand-alone application management outsourcing.

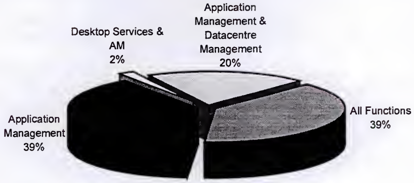
In particular , there are some signs of dissatisfaction amongst organisations that have outsourced desktop services in combination with other IT functions. This, and the other market changes outlined above, will lead to some reduction in service bundling in the future. However, in order to gain wider access to the market, desktop services outsourcing specialists still need:

- To demonstrate their high level of specialist capability to organisations evaluating outsourcing
- To develop partnerships with existing outsourcing vendors that do not wish to develop their own desktop services capability.

Applications management vendors face similar issues, historically having direct access to approximately 40% of the application management market (see Exhibit 7).

Exhibit 7

Accessibility of Application Management Market



Sample of 75 Outsourcing clients

Source: INPUT

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The bundling patterns adopted by organisations are important in determining niche vendors' ability to access their markets. At present, bundling patterns are severely limiting market access by specialist desktop services vendors. On the basis of current contracts, these specialists have access to only 14% of the desktop services outsourcing market, suggesting a strong need for partnerships with other outsourcing service providers.

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Process manufacturing	70	50	80	50	50
Utilities	45	45	35	80	55
Government	85	55	55	65	45
Financial Services	60	15	50	50	15
Business Services	75	10	20	40	30
All sectors	80	40	50	55	35

Source: INPUT

Note: This exhibit shows the proportion (%) of organisations already outsourcing that outsource each IT function.

There is a marked variation by sector. For example:

- The discrete manufacturing sector has a high concentration of datacentre management and a low propensity to outsource application management
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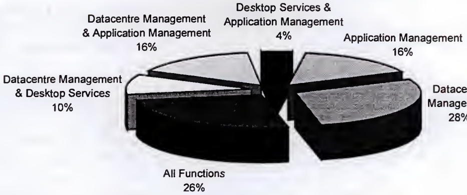
Outsourcing Service Combinations



Sample of 130 Outsourcing clients

Source: INPUT

Exhibit 3

Outsourcing Service Combinations by Industry

Sector	All functions	Datacentre Management & Desktop Services	Datacentre Management & Application Management	Desktop Services & Application Management	Desktop Services only	Application Management only	Datacentre Management only
Discrete Manufacturing	29	12	0	0	0	0	59
Process manufacturing	30	10	10	10	0	20	20
Utilities	30	10	10	10	0	40	0
Government	48	5	11	2	0	9	25
Financial Services	0	14	24	5	0	29	29
Business Services	0	13	27	7	0	13	40
Distribution	0	20	60	0	0	20	0

Source: INPUT

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Only a quarter of organisations already outsource datacentre management, desktop services and application management. For the purposes of this analysis, application management has been included if either application maintenance management or application development management has been outsourced.

No organisations were identified that currently outsourced desktop services but no other IT function. In past surveys by INPUT, many organisations have been found to outsource desktop services either in combination with datacentre operations or as a second stage in outsourcing, following on from datacentre operations. This appears to still largely apply.

Government organisations, including central government, local government and healthcare, have a relatively high propensity to outsource a wide range of IT functions, making them a natural target for full-service outsourcing vendors.

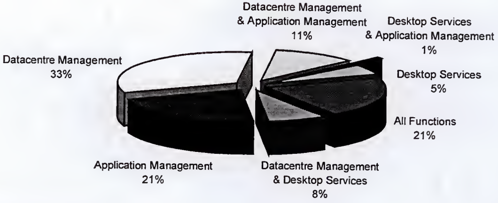
Organisations In The Financial Services Sector Tend To Adopt A Highly Selective Approach To Outsourcing

However, organisations that are outsourcing a wide range of functions may still decide to outsource to multiple best of breed vendors rather than a single full-service vendor. Exhibits 4 & 5 indicate the profile of outsourcing contracts that emerge from the vendor perspective once bundling is taken into account.

Exhibit 4 shows the overall profile of contract types that are currently outsourced to vendors. Exhibit 5 indicates the contract profile by industry sector.

Exhibit 4

Outsourcing Contract Profile



Sample of 130 Outsourcing clients

Source: INPUT

Exhibit 5

Outsourcing Contract Profile by Industry

Sector	All functions	Datacentre Management & Desktop Services	Datacentre Management & Application Management	Desktop Services & Application Management	Desktop Services	Application Management	Datacentre Management
Discrete Manufacturing	28	6	0	0	6	0	61
Process manufacturing	17	17	8	0	8	33	17
Utilities	15	0	8	8	15	38	15
Government	44	7	11	2	0	11	24
Financial Services	0	13	13	0	4	38	33
Business Services	0	6	17	0	11	22	44
Distribution	0	17	33	0	0	33	17

Source: INPUT

The highest level of service bundling is in the Government sector and the lowest in financial and business services.

The sectors that have so far been most inclined to outsource stand-alone desktop services are the utilities and business services sectors.

The sectors that have so far been most inclined to outsource stand-alone application management services are the utilities and financial services sectors.

Specialist Vendors Need to Develop Partnerships

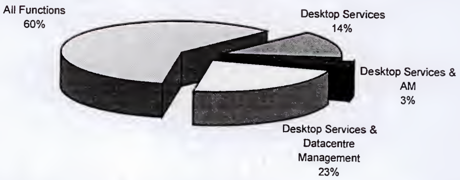
The current level of service bundling potentially restricts the market access of specialist vendors of desktop services and application management.

In particular, desktop services have historically been highly bundled in full-service contracts or incorporated into datacentre management contracts.

Exhibit 6 shows the profile of contracts containing desktop services outsourcing.

Exhibit 6

Accessibility of Desktop Services Market



Sample of 55 Outsourcing clients

Source: INPUT

Historically, only 14% of the desktop services market has been accessible to dedicated desktop services suppliers.

In the near future, INPUT expects the following trends in service bundling:

- A continuation of full service bundling amongst multinationals, particularly in the government and discrete manufacturing sectors
- Some unbundling of services at contract renewal, particularly in medium-sized contracts
- Increased outsourcing of client/server infrastructure management in the form of WAN management combined with desktop services outsourcing
- Increased stand-alone desktop services activity in the financial services sector
- A reduction in the level of stand-alone datacentre management outsourcing
- A greater emphasis on application development leading to higher levels of stand-alone application management outsourcing.

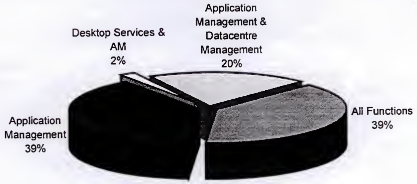
In particular , there are some signs of dissatisfaction amongst organisations that have outsourced desktop services in combination with other IT functions. This, and the other market changes outlined above, will lead to some reduction in service bundling in the future. However, in order to gain wider access to the market, desktop services outsourcing specialists still need:

- To demonstrate their high level of specialist capability to organisations evaluating outsourcing
- To develop partnerships with existing outsourcing vendors that do not wish to develop their own desktop services capability.

Applications management vendors face similar issues, historically having direct access to approximately 40% of the application management market (see Exhibit 7).

Exhibit 7

Accessibility of Application Management Market



Sample of 75 Outsourcing clients

Source: INPUT

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- Market strategies and tactics
- Product/service opportunities
- Customer satisfaction levels
- Competitive positioning
- Acquisition targets

For Buyers–evaluate:

- Specific vendor capabilities
- Outsourcing options
- Systems plans
- Peer position

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Research Bulletin

A Publication from INPUT's Outsourcing Programme - Europe

Vol. VII, No. 6

1996

Market Potential for European Business Operations Outsourcing Exceeds $650 Billion

The IT outsourcing market in Europe is now well-established. Indeed growth in the IT outsourcing market is accelerating, even in relatively mature outsourcing markets such as the U.K.

One factor contributing to this growth pattern is the removal of the fear factor. As IT outsourcing has become more widespread, so it has become increasingly accepted as a standard business tool and no longer solely the province of early adopters.

Business operations outsourcing is not yet so widely established and remains at present mainly confined to early adopters. However it will be an increasingly important market and vendors now need to identify their strategies for targeting this market. In particular, vendors need to consider:

- The service offerings that they wish to develop
- The targeting and delivery of these offerings
- Which industry sectors show the highest propensity to outsource these business processes.

Identifying Service Offerings

Business operations outsourcing opportunities are already beginning to emerge in a number of areas including accounting services, payroll, pensions and human resources administration, supply chain management, and customer services.

Exhibit 1 estimates the European expenditure, and hence market potential, for these and other business operations activities.

Exhibit 1

Business Operations Outsourcing Market Potential

Activity	Average Proportion of organisation al revenue (%)	European Expenditure ($ Billion)	European Expenditure within Large Organisations ($ Billion)	European Expenditure within SMEs ($ Billion)
Accounting Services	0.38	46	14	32
- Accounts receivable	0.21	25	8	17
- Accounts payable	0.14	17	5	12
Payroll & Pensions Administration	0.15	18	6	12
- Payroll	0.09	9	3.2	7.2
- Pensions	0.06	6	2.3	5.2
HR Administration	0.14	16	5	11
- Personnel Records	0.05	6	1.7	3.9
- Training administration	0.05	6	1.9	4.2
- Severance	0.04	5	1.4	3.2
Supply Chain Management	4.20	500	155	350
- Procurement	0.70	85	25	60
- Logistics	3.50	420	130	290
Customer Administration	0.68	80	25	55
- Order taking and fulfilment	0.33	40	12	25
- Customer service desks	0.35	40	13	30
Total	5.5	650	200	450

Source: INPUT

Small and medium-sized organisations (SMEs) are defined in this instance as organisations with less than 500 employees.

At present, many organisations remain relatively apprehensive about outsourcing functions that are a potential source of competitive advantage, such as customer service desks, preferring to outsource non-core activities such as payroll and pensions administration.

However, organisations are also strongly driven by internal cost pressures and, as in IT outsourcing, a high level of cost pressure will often overcome any concerns an organisation might have about outsourcing a relatively core business process.

Targeting Business Operations Outsourcing

There are a number of approaches that vendors can take in targeting the business operations outsourcing market.

Firstly a considerable difference in approach is often required between targeting small to medium-sized organisations and large organisations.

Small to medium-sized organisations will often have the greatest need for business operations outsourcing, since with a limited number of personnel they will typically wish to focus on their core business rather than support functions. In addition, they will find it harder than large organisations to cost-effectively maintain the skills they require in-house.

However, these same issues form a major challenge for vendors targeting these organisations. In particular, the need for cost-effective service delivery typically leads to highly packaged offerings emphasising remote delivery. This approach is common in payroll and pensions administration where it has been adopted by vendors such as Ceridian, CMG and ITnet.

These same vendors offer a much more customised approach for larger organisations.

Secondly, vendors need to identify their source of business operations delivery capability. There are two extremes of approach currently being adopted in the market. Firstly some vendors are building on existing bureau services and adding clerical capability to turn these offerings into managed services. This approach is typically used for functions such as payroll services and shareholder services.

At the other extreme, vendors are forming joint ventures with service departments from major organisations. Andersen Consulting has adopted this approach with the message that Andersen Consulting will deliver reengineering of the business processes while the client's personnel provide day-to-day operational knowledge and capability.

A third approach to the market is to target start-up corporations and management buy-outs that lack the necessary in-house support departments. Such organisations are typically interested in quickly establishing the necessary support functions but do not wish to develop in-house capability.

A number of IT outsourcing contracts have already arisen from organisations that do not wish to establish in-house IT departments and there is now scope for vendors to offer a range of additional support services.

For example, Axime, in France, is successfully targeting start-ups in this way and has found that it has a competitive advantage over other IT outsourcing vendors in situations where it can offer additional support skills such as billing and means of payment services.

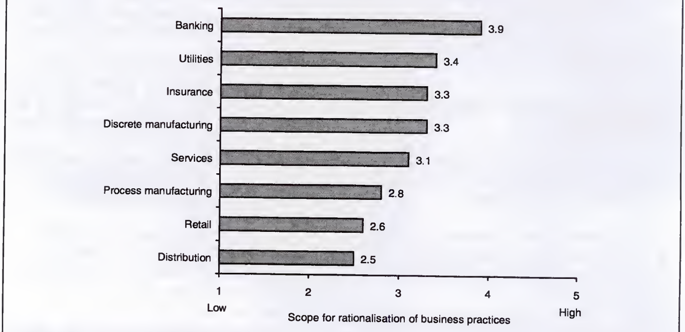
Finally, there is often scope to rationalise support functions within a single group of companies. One example of this approach is the contract between Sears and Andersen

Consulting where Andersen Consulting will provide common IT and accounting services across the subsidiaries in the Sears group. Previously each subsidiary typically provided its own accounting services.

This approach could have widespread application. Exhibit 2 lists the extent to which board members in various industries perceived scope for rationalisation of business practices across business units or subsidiaries within their organisation.

Exhibit 2

Scope for Rationalisation of Business Practices by Sector



Sample of 84 board members. Standard error = 0.3

Source: INPUT

Overall, over a third of board members strongly believe scope for rationalisation to exist, with this view held most strongly in the financial services and utilities sector.

Whichever approach vendors initially adopt, it is important that they achieve the critical mass to deliver ongoing cost and service improvements.

Industry-Specific Opportunities

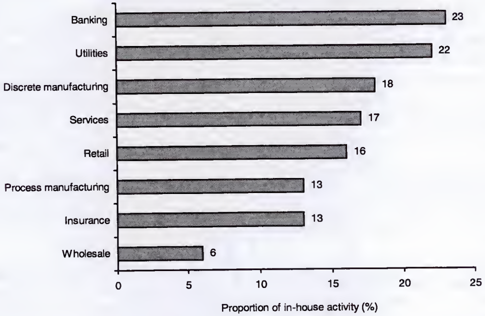
Many of the opportunities described above are applicable across industry sectors. However, there is also some variation by industry sector. For example, the opportunity to bundle IT outsourcing with accounting and, possibly, customer services for start-up organisations is highest in those sectors with the highest start-up activity. These tend to be the newer industry sectors such as telecommunications, media, biotechnology and business services.

Similarly, organisations with high staff turnovers, often found in the retail sector, will tend to be particularly appropriate targets for payroll and human resources administration services.

Indeed some sectors display a greater overall propensity to adopt business operations outsourcing than others. Exhibit 3 lists by industry sector the average proportion of current in-house business activity that board members expect to outsource by the year 2000.

Exhibit 3

Increase in Outsourced Business Activity by Year 2000 by Sector



Sample of 74 board members. Standard error = 4%

Source: INPUT

The banking sector is currently facing circumstances that favour business operations outsourcing. In particular, this sector expects declining volumes for its present, manpower-intensive ways of working and a need to develop new ways of conducting business.

This particularly applies to the retail banking sector as it makes the transition from branch to electronic banking.

In response banks will continue to outsource services with declining volumes such as cheque processing.

In addition, customer services desks, which will become increasingly vital for the industry, face increasing levels of investment and skill pressure as the banking sector moves to electronic rather than branch banking.

At the same time, the skills required from personnel manning the customer service desks will change. While banks may be reluctant to outsource customer facing activity, they will encounter a new need to provide their clients with technical support for electronic banking services and this could become a major support opportunity for outsourcing vendors.

Securities processing is another back-office function within the banking sector that is under significant cost pressure and is a potential candidate for business operations outsourcing.

The insurance sector is also facing a period of considerable change coupled to a need to reduce the cost of back-office administration services. So far, IT vendors have not managed to acquire business operations outsourcing contracts as a result of these changes. Instead there has been a high level of acquisition activity within the sector and organisations providing specialist services to the industry such as WM Company have been awarded business operations outsourcing contracts.

For example, in the U.K., Scottish Widows has transferred the administration of its $30 billion investment portfolio to WM Company.

Scottish Widows will continue to manage the portfolio and decide where funds are placed. However the administration, including trade settlement, securities reconciliation, income collection and tax recovery will be performed by WM.

The utilities sector is also being actively targeted by vendors and Andersen Consulting has established a joint venture company with Thames Water to offer logistics services. Other vendors are targeting administrative services such as billing. Capita has formed a joint venture with Yorkshire Water, and United Utilities - a merger of Norweb and North West Water - is also targeting billing services through its Vertex subsidiary. However, it again appears that much of the apparent scope for supplying business operations outsourcing services in the U.K. utilities sector will disappear in a wave of acquisition activity within the industry.

Overall the current pattern of business operations outsourcing opportunity by industry sector is listed in Exhibit 4.

Exhibit 4

Emerging Opportunities by Industry Sector

Industry Sector	Short-Term Opportunities	Medium-Term Opportunities
Banking	Cheque Processing ATM Management	Securities Handling Payroll & HR Administration
Insurance	Settlement Services	Policy Administration
Discrete Manufacturing	Accounting Services	Procurement Administration Supply Chain Management
Process Manufacturing	Accounting Services	Procurement Administration Supply Chain Management
Retail	Payroll & HR Administration	Supply Chain Management
Wholesale	Customer Services	Supply Chain Management
Utilities	Supply Chain Management Customer Services	Accounting Services

Source: INPUT

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Research Bulletin

A Publication from INPUT's Outsourcing Programme - Europe

Vol. VII, No. 7 1996

Year 2000 Issues Create Major Opportunities for European Outsourcing Vendors

The Year 2000 issue is often presented as an application maintenance problem to be tackled with the assistance of teams of body-shop personnel. However, the issue is more wide-ranging than this and presents a major source of new opportunity for creative outsourcing vendors.

The factors underlying this major source of opportunity include:

- The problems caused by the Year 2000 date change extend far beyond in-house developed applications
- The financial and psychological motivation to disguise the true cost of correction
- A modest switch to outsourcing could increase European outsourcing growth rates by over 10% per annum.

Not Just The COBOL Applications

The Year 2000 problem is not confined to systems developed in-house many years ago. It will impact systems built around application software products, particularly those based on comparatively early versions of software products. It also emerges in systems software affecting both mainframes and distributed systems.

For example, at the desktop level, many PCs when set to midnight on 31st December 1999 currently revert to January 4, 1980.

For organisations with large distributed populations of PCs, this can create a need for well co-ordinated infrastructure management. However, even this aspect of the Year 2000 problem is relatively easy to define and manage compared to many others that will arise. For example, the maintenance of user developed applications using popular personal productivity tools such as Excel will generate a need for major user education and help-desk support programmes both before and immediately after December 31st, 1999.

This will require organisations to have robust systems management and support mechanisms in place well before the Year 2000. This need is likely to act as an additional driver leading organisations to outsource their desktop and distributed systems management.

Where's The Value For Money?

The Year 2000 issue also has to be considered in terms of human psychology, in particular the perceived value for money derived from various approaches to the problem.

Exhibit 1 lists the advantages and disadvantages of each of a range of possible solutions to the Year 2000 problem.

Exhibit 1

Alternative Solutions to Year 2000 Issues

Option	Advantages	Disadvantages
Correct the code	Tackles the problem	Very expensive No obvious return on investment Presents negative image of the IT department
Re-implement the application	Provides opportunity to reengineer/ implement new functionality Demonstrable return on investment from new functionality	Impossible to replace all applications simultaneously Even more expensive? Have to ensure implementation is on time
Outsource maintenance of existing applications	Transfers the problem to a third-party Increases access to expertise and flexible resourcing May be able to spread the cost over a longer timescale Enables IT department to focus on critical new systems development/ implementation	Still left with risks inherent in user developed applications and IT infrastructure
Outsource all application management	As above but also assistance in ensuring that new development takes place in desired timescales	Still left with risks inherent in user developed applications and IT infrastructure
Outsource the IT function	Enables entire risk transfer to third-party, optionally with pricing linked to success in risk management Enables creative forms of pricing to be adopted, possibly spreading the Year 2000 cost over the life of the contract Covers infrastructure stabilisation issues as well as application stabilisation Access to extensive user help-desk to manage problems caused by desktop applications that avoid detection	Will the outsourcer be able to deliver? Will the outsourcer be prepared to take sufficient risk?

Source: INPUT

The technical fix approach to the Year 2000 problem offers no guarantee that every date will be spotted and low value for money in terms of advancing the application of IT to the underlying business.

In order to show greater advancement in the use of IT, many organisations will choose to redevelop key systems rather than correct them. However within this scenario, organisations will need to be absolutely sure that development finishes on schedule. This will create application management opportunities with vendors either managing existing applications to enable the in-house organisation to refocus its efforts or taking over the management of all development activities.

Outsourcing can also offer important psychological benefits to organisations facing Year 2000 issues. For example, it can be used to transfer the risk to a third-party. It can also be used to disguise the true cost of systems correction by spreading the Year 2000 costs over the life of the contract.

When cost spreading is combined with the higher value for money associated with outsourcing, the Year 2000 costs may be much less apparent to the CFO.

Vendors should take advantage of these important factors by developing innovative contractual and pricing approaches in addressing Year 2000 issues.

Overall, outsourcing is still driven by:

- A need for change, typically involving new systems development
- Financial pressures and a desire for greater value for money
- Skills access
- Risk transfer.

The Year 2000 issue will place many organisations in a situation with precisely these characteristics leading to a significant growth in IT outsourcing in Europe.

Exhibit 2 lists a scenario indicating the proportions of systems that might be tackled using each of the alternatives discussed above.

Exhibit 2

Profile of Approaches to Year 2000

Approach to Year 2000	Proportion of systems(%)
Audit and fix code	75
Build replacement systems	15
Outsource application maintenance of range of current systems	8
Outsource all application management	1
Outsource complete IT function	1

Source: INPUT

In addition, these levels of outsourcing might be complemented by organisations outsourcing 3% of their desktop services in response to the systems management issues discussed earlier.

Outsourcing to Grow by Approximately 35% Per Annum

Even this relatively modest switch to outsourcing in the face of Year 2000 pressures will result in high growth in the outsourcing market.

Exhibits 3 shows the forecast penetration of outsourcing by IT service within large organisations in the Year 2000 without taking the impact of Year 2000 factors into account. It is assumed that outsourcing is currently primarily found within large organisations that account for half of total IT expenditure.

The impact of introducing Year 2000 factors into this scenario is shown in Exhibit 4. This exhibit assumes that organisations will approach the Year 2000 in the manner manner shown earlier in Exhibit 2.

Exhibit 3

Outsourcing Penetration by Service: Europe, 2000

Europe 2000	Datacentre Management	Desktop and LAN Management	Wide Area Network Management	Application Management	Total
IT Expenditure ($m)	93600	68640	46800	102960	312000
Large Organisations:					
IT Expenditure ($m)	46800	34320	23400	51480	156000
Outsourcing expenditure ($m)	5418	2150	3300	4433	15300
Outsourcing penetration (%)	12%	6%	14%	9%	10%
Average Annual Growth in Outsourcing 1996 - 2000 (%)	13%	21%	49%	28%	23%

Source: INPUT

Exhibit 4

Impact of Year 2000 Factors On Outsourcing Penetration: Europe, 2000

	Datacentre management	Desktop and LAN Management	Wide Area Network Management	Application Management	Total
Impact of Year 2000 factors on outsourcing	Moderate	Medium-High	Low	Very High	n/a
Increase in proportion of large organisations outsourcing between 1996 and 2000	+3%	+4%	+1%	+6%	n/a
Outsourcing penetration within large organisations by Year 2000	15%	10%	15%	15%	14%
Outsourcing expenditure - large organisations ($m)	7000	3400	3500	7700	21700
Average Annual Growth in Outsourcing(%)	20%	36%	51%	47%	34%

Source: INPUT

Even these relatively low levels of switching to outsourcing as a direct result of Year 2000 factors produce a considerable increase in European outsourcing activity, with the overall outsourcing market, desktop services outsourcing and application management all experiencing growth well in excess of 30%.

In addition, vendors will use Year 2000 projects based around code auditing and fixing as a trojan horse to introduce organisations to the concepts of application management and IT outsourcing and to demonstrate their own IT management capabilities. Consequently, a proportion of projects that begin as traditional Year 2000 support will subsequently develop into outsourcing contracts.

For example, EDS is currently assisting Morgan Stanley in the Year 2000 certification of all its information systems. Morgan Stanley has been dissatisfied with its internal IT performance in the past and it is not inconceivable that EDS will enter into an outsourcing contract with Morgan Stanley at some point in the future.

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A Publication from INPUT's Outsourcing Programme - Europe

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The Focus on Business Process Improvement Continues

Outsourcing is often most strongly favoured by organisations in weak financial circumstances. Indeed, the level of demand for outsourcing is strongly influenced by the extent to which individual organisations face a strong need for business change combined with cost reduction pressures.

It is not uncommon to discover that organisations that have undertaken IT outsourcing are subsequently divesting a number of divisions, undertaking far-reaching business rationalisation exercises, or making major changes to their ways of conducting business.

On the basis of this model, the current business climate in Europe is a very encouraging one for outsourcing vendors, since:

- Organisations are still striving to become more cost-effective
- IT departments remain under cost pressure
- IT departments often lack the ability to support the reengineering of business processes.

Organisational Efficiency Heads List of Business Priorities

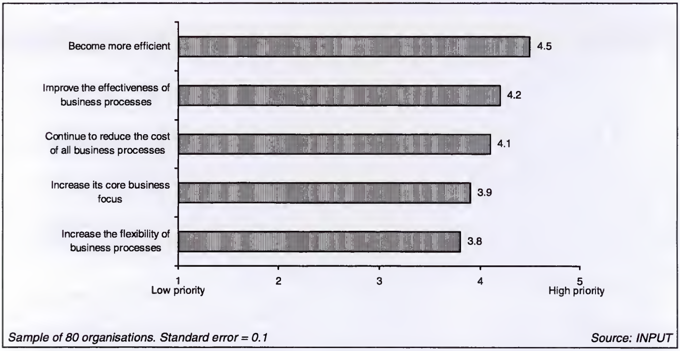
Exhibit 1 lists the main organisational priorities arising from a recent INPUT study.

Overall 85% of respondents across a wide range of industry sectors strongly expressed the view that their organisations needed to become more efficient.

Another theme to emerge from this research was a very strong focus on business process improvement. Here the emphasis is on all-round improvement, with business processes needing to simultaneously become more effective, more flexible in their ability to adapt to future business change, and less costly.

Exhibit 1

Organisational Priorities



Sample of 80 organisations. Standard error = 0.1

Source: INPUT

These requirements exactly mirror the expectations of IT outsourcing clients who typically want to simultaneously:

- Improve the application of IT to the business (effectiveness)
- Introduce greater flexibility into the application of IT
- Improve the cost-effectiveness of IT.

IT Departments Remain Under Cost Pressure

The impact of business priorities such as those listed above on in-house IT departments is shown in Exhibit 2.

Exhibit 2

Challenges for IT Departments

Challenge	Importance	Ability to cope	Difference
Become more cost-effective in using IT	4.1	3.2	0.9
Improve focus on responding to business needs	4.0	3.3	0.7
Become more proactive in meeting business needs	3.5	3.1	0.4
Update internal skills	3.8	3.4	0.3
Improve support for distributed and desktop systems	3.6	3.4	0.2
Move to a new generation of applications	3.9	3.7	0.2
Adopt a distributed IT architecture	3.4	3.4	0.0
Reduce the time taken to implement new applications	3.3	3.3	0.0

Source: INPUT

This exhibit lists the importance of each of a number of challenges facing in-house IT departments together with IT departments' perceived ability to meet each of these challenges.

IT departments face a challenge in acquiring up-to-date skills and maintaining the required skill mixes. Overall, a third of respondents perceived that they were inhibited in achieving their IT goals by skill mix issues.

However, although a problem, the main issue for IT departments is not their understanding of new technologies, it is their ability to apply these both proactively and cost-effectively to business processes.

There are no signs of the current high levels of cost pressure on IT departments abating. Comparisons with the equivalent INPUT research twelve months ago indicates no change in cost pressure over this period.

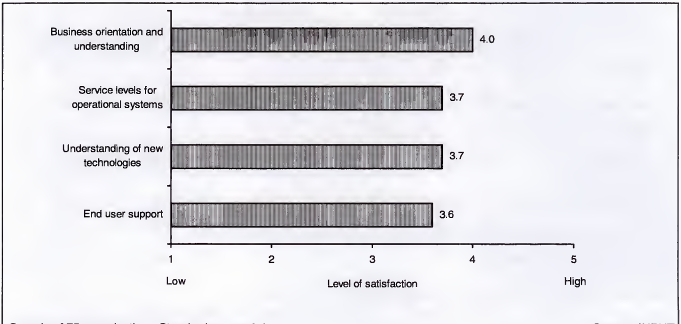
Indeed the demand for value for money may increase alongside the rising demand for services. Over half of the respondents anticipate a significant increase in application development and support activity over the next few years.

IT Departments Require Support for the Reengineering of Business Processes

Exhibits 3 and 4 list the perceived strengths and weaknesses of IT departments.

Exhibit 3

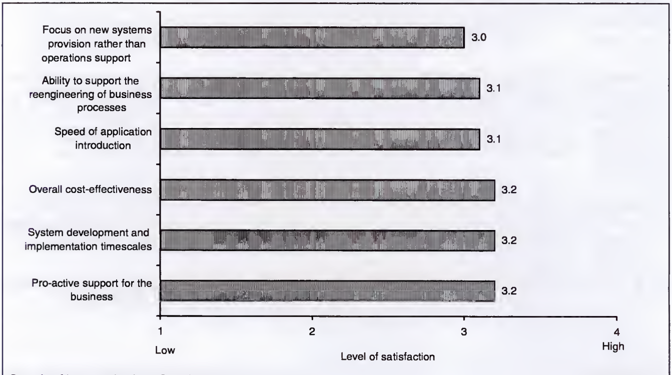
IT Department Strengths



Sample of 75 organisation. Standard error = 0.1 *Source: INPUT*

Exhibit 4

IT Department Weaknesses



Sample of 75 organisation. Standard error = 0.1 *Source: INPUT*

Outsourcing vendors can assist organisations by providing cost-effective infrastructure management services combined with process reengineering know-how.

IT departments are perceived to provide medium to high quality operational and user support but need to redeploy resources from operational activities to increase their focus on using IT in a business development role.

In support of this business development role, IT departments have an adequate understanding of new technologies and a very good understanding of their organisations' current business and ways of working.

However, they often lack the reengineering skills necessary to propose, and utilise new technology in support of, more-effective ways of working. This is a key skill that outsourcing vendors should offer to all their clients.

In addition, IT departments are experiencing difficulty in managing the desktop and LAN environment. However respondents on average attached relatively low importance to desktop support. The main priority for action at present is perceived to be support for local area networks, involving services such as LAN monitoring.

This Research Bulletin is issued as part of INPUT's Outsourcing Programme - Europe. If you have any questions or comments about this bulletin contact John Willmott at Cornwall House, 55-77 High Street, Slough, Berkshire, SL1 1DZ, United Kingdom. Tel: (0)1753 530444. info@input.co.uk

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INPUT

Research Bulletin

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IT Infrastructure Management Vendors Must Develop a More Proactive Message

Opportunities are growing in IT infrastructure management. INPUT predicts that user expenditure on IT infrastructure management in Europe will increase by 27% between 1996 and 2001, from approximately $4,000m to $14,000m.

However, in order to be successful in this market, vendors will need to change the emphasis of their marketing messages from chaos and cost of ownership.

These negative messages have so far achieved little in the promotion of desktop services outsourcing. Instead IT infrastructure management vendors should build on the example set by EDS. EDS has been the most successful outsourcing vendor in Europe in the early 1990s. Much of this success has been built around promotion of the concept of business value. By adopting this message, EDS has successfully differentiated itself from much of the outsourcing community which has often promoted technology management capability rather than business focus.

Vendors promoting IT infrastructure management services now need to position themselves in a similar manner. In particular, they should de-emphasise their chaos and cost of ownership rhetoric and adopt a more positive approach to marketing IT infrastructure outsourcing since organisations now:

- Recognise the need to develop their IT infrastructures as business enablers
- View outsourcing as an increasingly acceptable means of developing their infrastructure management capability
- Regard more rapid application introduction as the key benefit to be derived from IT infrastructure management outsourcing.

Investing in IT Infrastructure Development to Improve Business Support

There is much discussion within the industry concerning the relative cost of supporting differing platforms. However, although organisations require value for money from their IT infrastructure investments, their main priority is to provide enhanced support for business growth and competitiveness.

Exhibit 1 lists the major challenges that organisations face in developing their IT infrastructures.

Overall the use of IT, within many organisations, is developing rapidly. This is particularly true in the banking sector which is undergoing major change - much of it fuelled by the possibilities created by new technology.

Similar trends are emerging in the services and retail sectors as organisations move towards electronic commerce.

Indeed, senior executives in Europe are currently very concerned with improving their communications links with customers and suppliers.

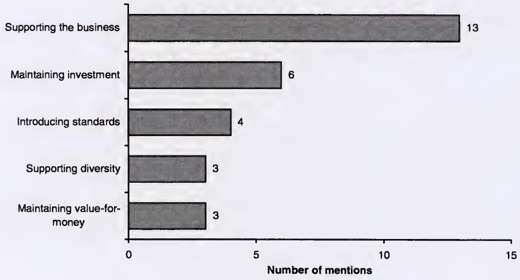
A coherent enterprise-wide IT infrastructure is an essential prerequisite for successful electronic commerce.

Within this context, the majority (55%) of IT Directors within organisations surveyed stated that their organisation was highly prepared to invest in the development of its IT infrastructure. A similar proportion of organisations were highly prepared to invest in the systems management of their IT infrastructure.

Exhibit 2 lists the perceived level of need for each of a number of potential infrastructure development activities.

Exhibit 1

IT Infrastructure Development Challenges

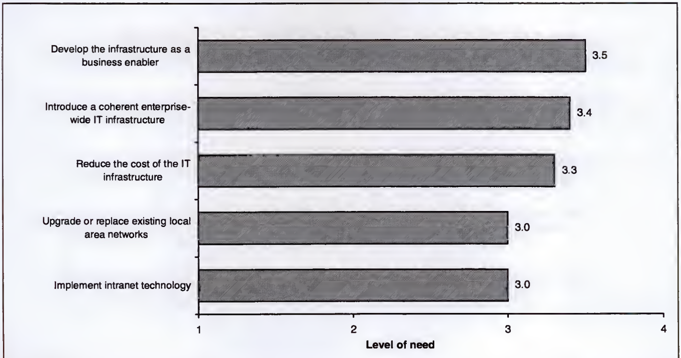


Sample of 120 IT Directors

Source: INPUT

Exhibit 2

Priorities for IT Infrastructure Development



Sample of 120 IT Directors. Standard error = 0.1

Source: INPUT

Although cost reduction emerges more strongly in this exhibit than the previous one, the key theme remains the need to develop a highly integrated IT infrastructure that will provide a high level of business support.

Again, this need for business support is often being driven by the increasing importance of IT in providing support for customer facing activities.

Intranet technology is one means of facilitating communication both within and externally to the organisation. Approximately 35% of IT managers surveyed expressed a strong need to implement Intranet technology as part of their IT infrastructure. However, Intranet technology is not seen as a replacement for other technologies. In terms of IT infrastructure management, the use of Intranet technology merely adds another technology to the existing high level of heterogeneity and complexity.

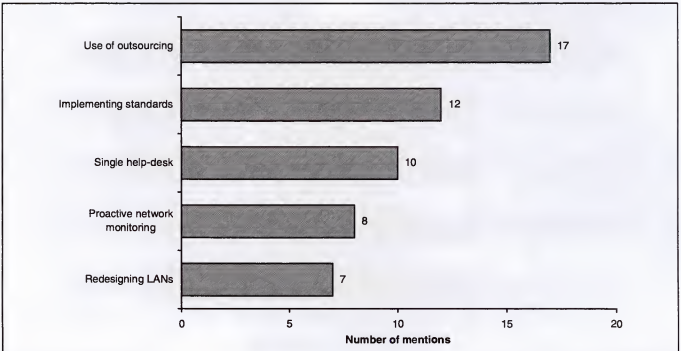
Accordingly its introduction can make systems management more complex, not less so.

Outsourcing is an Acceptable Means of Improving Infrastructure Management

Exhibit 3 lists the principal steps that organisations intend to take in the next twelve months to develop their IT infrastructure management capability.

Exhibit 3

Development of Infrastructure Management Capability



Sample of 120 IT Directors

Source: INPUT

The majority of organisations now recognise the importance of implementing standards by adoption of a common operating environment, the role of a single enterprise help-desk in facilitating problem management, and the use of remote network management for performance monitoring.

While many organisations are in the process of implementing these features in-house, there is also considerable emphasis on outsourcing operational duties, with a number of the organisations interviewed already in the process of evaluating outsourcing vendor capabilities in this area.

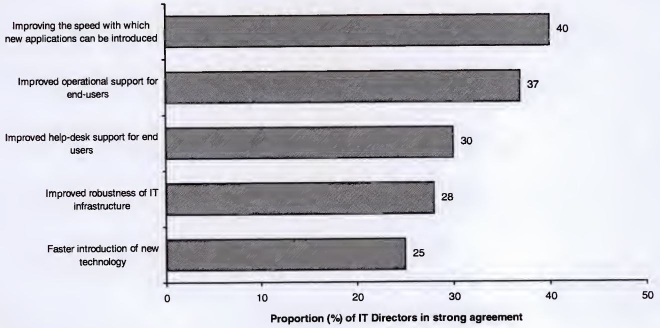
Indeed, organisations now show an increasing propensity to outsource their entire IT infrastructure management rather than just specific elements such as datacentre operations. Overall, 25% of IT managers in this survey strongly favoured outsourcing the operation and support of their organisation's IT infrastructure.

Rapid Application Introduction is the Real Benefit of Infrastructure Outsourcing

Exhibit 4 lists the major benefits that organisations believe would be delivered by outsourcing their IT infrastructure.

Exhibit 4

Benefits from Infrastructure Management Outsourcing



Sample of 100 IT Directors. Standard error = 5%

Source: INPUT

Surprisingly, fewer than a quarter of IT managers strongly perceive that outsourcing management of the IT infrastructure would assist them in reducing either real operations and support costs or hidden operations and support costs.

Even fewer IT managers strongly perceive that outsourcing would lead to improved network performance.

While approximately 30% of IT managers strongly believe that outsourcing would improve the overall robustness of their IT infrastructure, the main benefit of IT infrastructure outsourcing is perceived to be improving the speed with which new applications can be introduced.

The second key benefit of IT infrastructure outsourcing is perceived to be improved support for end users. While vendors typically stress their ability to provide help-desk support, the most important element of this support is perceived by IT managers to be operational support.

In moving from a centralised to a distributed IT environment, users have often found their new operational duties, such as back-ups, to be much more onerous than they had previously envisaged. One of the goals for systems management within an enterprise infrastructure model is to remove all operational duties from the user, leaving him or her free to concentrate on their business role rather than IT operations.

Accordingly, outsourcing vendors should promote their ability to establish and support coherent enterprise-wide IT infrastructures, thereby improving the organisation's ability to introduce new systems rapidly, and their ability to relieve users of operational duties.

This Research Bulletin is issued as part of INPUT's Outsourcing Programme - Europe. If you have any questions or comments about this bulletin contact John Willmott at Cornwall House, 55-77 High Street, Slough, Berkshire, SL1 1DZ, United Kingdom. Tel: (0)1753 530444. email jwillmott@input.co.uk

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Research Bulletin

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Network Monitoring – The Key to Infrastructure Management Success?

Although the desktop services market is exhibiting high growth in Europe, vendors have found it hard to target this market. Much of the initial marketing was based on an expectation that desktop audits and asset management surveys would lead to comprehensive desktop services outsourcing contracts.

However, this strategy has historically had a relatively low level of success and is unlikely to be more successful in the immediate future. The reasons for this are as follows:

- Firstly, organisations now need to manage their IT infrastructures as a single integrated entity rather than as a series of distinct technical components.
- Secondly, organisations are typically seeking a more tangible contribution than asset management to assist them in achieving stable enterprise-wide IT infrastructures.

Network monitoring, rather than asset management, may be one of the keys to future success, since:

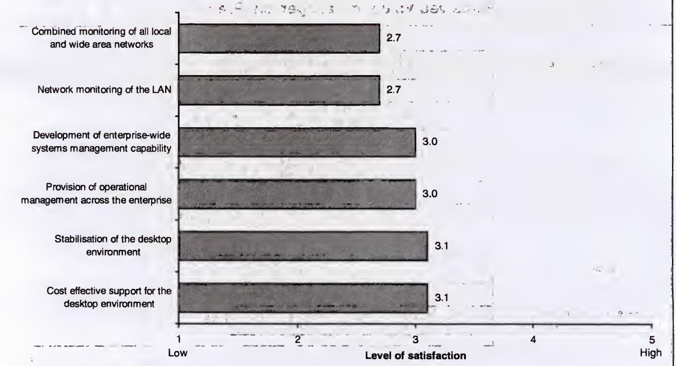
- Organisations are very dissatisfied with their current network monitoring capability
- IT directors perceive a relatively high need for external assistance in network monitoring
- Network monitoring is critical to the successful implementation of enterprise-wide service management.

Current Network Monitoring is Inadequate

Exhibit 1 lists a number of areas where IT directors currently express relative dissatisfaction with their IT infrastructure management capability.

Exhibit 1

Areas of Low Satisfaction



Sample of 90 IT Directors. Standard error = 0.1

Source: INPUT

IT directors remain seriously concerned about their ability to support the desktop environment. However IT directors exhibit even lower levels of satisfaction with their organisations' ability to monitor networks.

IT directors now increasingly recognise the importance of managing the IT infrastructure on an end to end basis. This need is being driven by intensification of the pressures for electronic communication, both within the organisation and with suppliers and customers. Accordingly, integrated network monitoring, covering both LANs and WANs, is required across the entire IT infrastructure.

Currently, approximately half of IT directors are dissatisfied with their network monitoring capability.

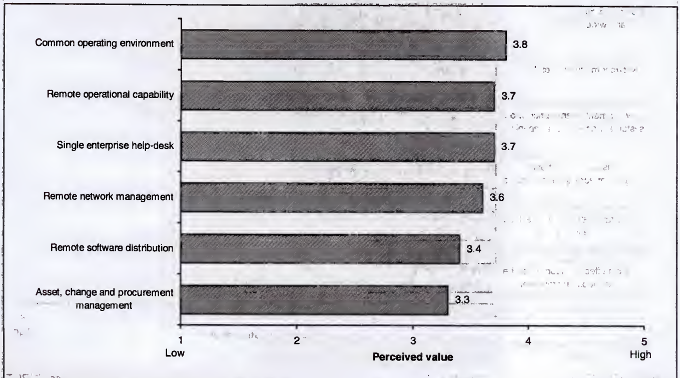
Exhibit 2 lists the perceived value to IT directors of each of a number of systems management features.

While the concept of the common operating environment is favoured, IT directors are more sceptical of the value of implementing asset, change management and remote software distribution.

The implementation of a single enterprise help-desk backed up by remote network monitoring and remote operations capability is regarded as more important.

Exhibit 2

Perceived Value of Management Practices



Sample of 120 IT Directors. Standard error = 0.1

Source: INPUT

The implementation of standards may be seen as a long-term task, since it may be both difficult and expensive to achieve a standardised environment in the short-term. Although vendors have developed offerings to spread the cost of standardisation exercises, IT directors in Europe are typically not in favour of this approach.

At present, the majority of IT directors strongly favour internal funding of capital costs. Only 10% of IT directors strongly favour adopting a totally funded service price with the vendor funding capital investment.

Accordingly the implementation of enterprise help-desk and network management capability may be viewed as more achievable.

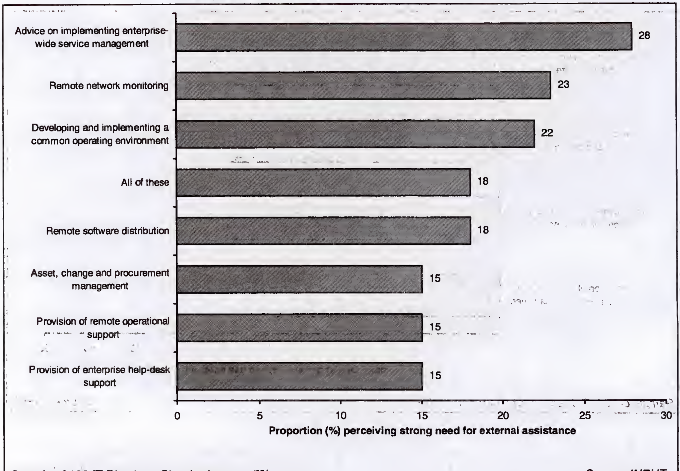
Organisations Need Help in Network Monitoring

Exhibit 3 lists the proportion of IT directors that perceive a strong need for external assistance in each of a number of areas of systems management.

This chart illustrates the point that organisations are moving towards an enterprise, rather than fragmented, view of systems management. For example, the majority of IT directors (60%) now perceive that the desktop environment should be managed and supported as part of the enterprise IT infrastructure and not as a distinct entity.

Exhibit 3

Perceived Need for External Assistance



Sample of 100 IT Directors. Standard error = 5% *Source: INPUT*

This is creating opportunities for vendors to offer consultancy services aimed at the design of frameworks for enterprise-wide systems management.

In terms of delivering systems management services, approximately a quarter of IT directors perceive a strong need for external assistance in remote network monitoring.

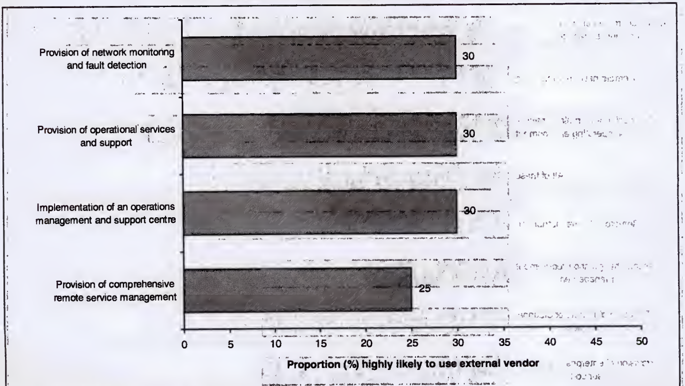
Exhibit 4 lists the proportions of organisations highly likely to use an external vendor for a number of key remote service management activities.

Overall approximately 45% of IT directors would be highly likely to use an external vendor for either:

- Provision of network monitoring and fault detection, or
- Implementation of an operations management and support centre.

Exhibit 4

Role of Vendor in Remote Service Management



Sample of 100 IT Directors: Standard error = 0.1

Source: INPUT

Exhibit 5 lists the extent to which IT directors perceive a need for external operations and support services across the various components of their IT infrastructures.

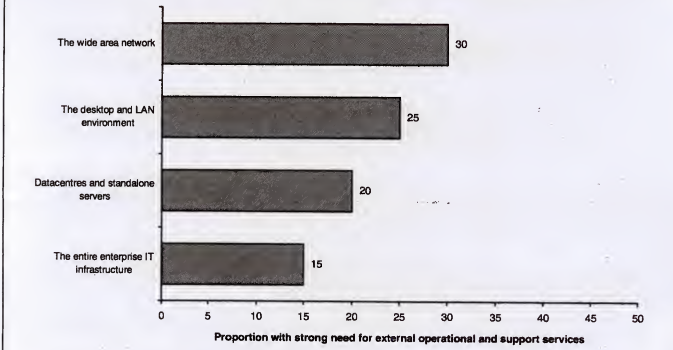
Support for wide area networks remains a major concern of IT directors. Approximately a third of IT directors are dissatisfied with their current ability to support WANs. This situation is exacerbated by the increasing pressure being put on WANs. Many organisations expect their usage of WANs to increase dramatically over the next few years.

Simultaneously, many organisations perceive a need to upgrade or redesign their existing LANs.

The net result is a considerable demand for network-centric external operations and support services.

Exhibit 5

Perceived Need for External Operations and Support Services



Sample of 105 IT Directors. Standard error = 0.1

Source: INPUT

Network Monitoring is Critical to Enterprise-Wide Infrastructure Management

The concept of enterprise infrastructure management is gaining in popularity. Recently there has been considerable activity on the part of the systems management tool providers. For example, in October, Tivoli announced its TME 10 Global Enterprise Manager, which is intended to offer a framework for integrated systems management across the enterprise.

Network monitoring is one of the key elements within such a framework, facilitating performance management and problem solving across the backbone of the IT infrastructure.

Without this key element, it is difficult to monitor or guarantee the performance of applications such as messaging, workflow, or data interchange — all of which are becoming of increasing importance.

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